ETHICAL CONSIDERATIONS FOR EMPLOYEE BENEFITS ATTORNEYS

Ethics for the Employee Benefits Attorney

The Employee Benefits Institute Workshop

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By

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I. <u>Who is the Client</u>?

The starting point for analyzing the ethical obligations of an employee benefits attorney is to identify the attorney's client. This may be more challenging than it sounds, due in part to the complexity of representing entities, such as plan sponsors or plans, rather than individuals. In representing a sponsoring employer in litigation, an attorney may, for example, work with employees or representatives of the employer who are themselves parties to the litigation. This can be troublesome given the ease with which the attorney can *unwittingly* come to represent one or more of those individuals, and thereby create a potential conflict of interest in his or her representation of the sponsoring employer. Adding to the confusion for those representing plans, it is not intuitively clear what it means to represent a "plan" as an entity distinct from the plan's fiduciaries and plan sponsor, and this can lead to difficulty in understanding the attorney's ethical obligations.

In ERISA litigation, an attorney will normally represent one or more of the following:

- A plan
- A plan sponsor (such as an employer in the case of a single employer arrangement, or a board of trustees in the case of a multiple or multi-employer plan)
- Individual fiduciaries, such as committee members or members of a board of trustees
- A business entity service provider, such as a corporate trustee, investment manager, third-party administrator, or recordkeeper (which service provider may be a fiduciary)
- Plan participants

II. <u>Representing Entities</u>.

As noted, an attorney may represent an entity such as a sponsoring employer, a plan, a board of trustees, an administrative committee, a corporate trustee, or other service provider. In that event, the ABA Model Rules of Professional Conduct (the "Model Rules") provide, in Rule 1.13, that the attorney represents the organization "acting through its duly authorized constituents," but does not automatically represent the constituents themselves. The Model Rules require that an attorney, when dealing with a client organization's directors, officers, employees, members, shareholders, or other constituents, explain that the attorney represents the organization whenever he or she knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the attorney is dealing. Model Rule 1.13(f).

A. **Communicating With Constituents.** When a constituent has his or her own counsel, the attorney for the organization must be careful to follow the rules for gaining consent from the constituent's attorney prior to communicating with the constituent. Model Rule 4.2. With respect to unrepresented constituents, the Model Rules emphasize the need for the attorney not to state or imply that he or she is disinterested and, when the attorney knows or reasonably should know that the constituent misunderstands the attorney's role, to make reasonable efforts to correct that misunderstanding. Model Rule 4.3. If the attorney knows or reasonably should know that the interests of the constituent are, or have a reasonable possibility of being, in conflict with the interests of the organization, the attorney must not give legal advice to the constituent, other than the advice to secure counsel. *Id*.

Where an organization is being sued, the general prohibition on communicating with parties who are represented (without consent of the parties' counsel) may prevent both the attorney for the organization and plaintiffs' counsel from obtaining statements from the organization's constituents. For the same reason, the attorney for an employer will normally be prohibited from contacting employees who are members of a plaintiff class without consent of class counsel. Similarly, plaintiffs' counsel may not, without the consent of the organization's counsel, communicate with constituents who have authority to bind the organization – that is, with constituents who have the authority to "obligate the organization with respect to the matter or whose act of omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability." Model Rule 4.2 cmt. [7]. *Compare Montgomery v. Aetna Plywood, Inc.*, 1996 U.S. Dist. LEXIS 9213 (N.D. Ill. 1996) (employer's counsel may not contact employee class members without consent, and class counsel may not contact senior management officials who are members of the class without leave from the court to do so) with *Ed Miniat, Inc. v. Globe Life Ins. Co*., 1989 U.S. Dist. LEXIS 2922 (N.D. Ill 1989) (in an employer's action against insurer relating to life insurance product, insurer's counsel consented to plaintiff employer's communication with insurer's former agent by threatening to sue agent). The same prohibition on contacting constituents applies to a constituent who supervises, directs, or regularly consults with the organization's attorney concerning the matter at hand. Model Rule 4.2 cmt. [7]. Consent of an organization's attorney is, however, generally not required for communication with a former constituent, though the rules for communicating with represented parties would apply should the former constituent be represented by counsel. *Id.*

B. **Inadvertent Representation Creating Conflicts**. Of particular concern for attorneys representing employers is the possibility of inadvertently forming an attorney-client relationship with a constituent of the employer. This may occur where the attorney fails to make clear that he or she represents only the organization. Restatement (Third) of the Law Governing Lawyers (2002) (the "Restatement") §14 cmt. f. This possibility of a constituent inadvertently becoming a client is particularly important because the professional rules concerning conflicts of interest may prevent an attorney from representing both an organization and a constituent. In particular, unless the parties consent, multiple representation will be impermissible if there is a substantial risk that the attorney's representation of either party would be adversely affected by his or her duties to the other. Restatement § 131 & cmt. a. As noted, this risk of disqualification can arise where an attorney represents both a plan sponsor and its constituents. *See, e.g., Montgomery Academy v. Kohn*, 50 F. Supp. 2d 344 (D. N.J.), *aff'd*, 82 F. Supp. 2d 312 (D. N.J. 1999) (magistrate's order) (attorney was disqualified from representing employer because she unintentionally represented trustee of pension fund who was subject to potential liability as a result of a fund investment). It can also occur where an attorney represents both a plan sponsor and the plan itself, or the plan and a fiduciary. *See, e.g., Schiffli Embroidery Workers Pension Fund v. Ryan, Beck & Co.*, 1994 WL 62124 (D. N.J. 1994) (plaintiff plan's counsel was disqualified where counsel had formed attorney-client relationship with trustee who was subsequently named as a defendant; client relationship was formed in the course of soliciting information from the trustee and having the trustee sign an affidavit despite the trustee's disagreement with certain statements therein).

1. **Counsel Does Not Represent Participants by Reason of Advising Fiduciary Committee.** In *Colucci v. Agfa Corp. Severance Pay Plan*, 431 F.3d 170 (4th Cir. 2005), the court, in a pre-*Glenn* case, considered the proper standard of review for a severance benefit dispute. The plaintiff argued that the court should not review the plan's decision under an abuse of discretion standard, but rather should scrutinize it less deferentially, because the plan administrator had a conflict of interest. Among three factors the plaintiff pointed to as demonstrating a conflict of interest, was the role of the administrative committee's outside legal counsel. The plaintiff asserted that legal counsel advised the plan committee as to its fiduciary duties and "therefore, in reality, [was] acting for the plan participant . . . . He was acting on behalf of [the plaintiff-participant] and he should not be defending a case brought against the plan by [the plaintiff]." (The other two factors the plaintiff argued should result in a less deferential standard of review concerned (a) the company's dual role in funding plan benefits and serving as the plan sponsor, plan administrator, and benefits administrator, and (b) the administrative committee members' status as company employees.)

   The court rejected the notion that an attorney who provides fiduciary advice constructively becomes a representative of plan beneficiaries. It also noted that any conflict counsel to the plan administrator may have is not the relevant inquiry in determining the standard of review. Instead, whether the court should apply heightened scrutiny would depend on the conflicts of the administrator, not conflicts of the administrator's counsel. The court put it this way:

> [The plaintiff] suggests that a conflict of interest could be presumed from the attendance of [Agfa's outside counsel] at the Administrative Committee's meeting because [Agfa's outside counsel] was advising the Committee and at the same time acting for [the plaintiff]. This suggestion, however, misunderstands the pertinent inquiry. Whether we heighten our scrutiny depends on an administrator's purported conflicts, not conflicts of the administrator's counsel. Moreover, [the plaintiff] fundamentally misconstrues [Agfa's outside counsel's] participation in the Administrative Committee's consideration of his appeal. An attorney who advised his clients of their fiduciary obligations does not constructively become the beneficiary's representative.

2. **<u>Inadvertent Representation of Corporate Officer: Stock Option Backdating Investigation</u>**. In a criminal case against the former CFO of Broadcom Corporation involving allegations of the improper backdating of stock options, the Ninth Circuit refused to suppress statements the former CFO made to the company's outside counsel. *U.S. v. Ruehle*, 583 F.3d 600 (9th Cir. 2009). The company's board of directors and company management had brought in the company's long-time outside counsel to commence an internal review of the company's current and past stock option granting practices. It was understood by those involved, including the CFO, that the results of that investigation would be disclosed to the company's outside independent auditors, who would have to review and opine on the accuracy of the company's audited financial statements and regulatory filings. Outside counsel, as part of its investigation, met with the CFO to discuss the company's stock option granting practices, including his role as the company's CFO.

   Outside counsel asserted that it gave the CFO a so-called *Upjohn* warning (named by reference to the Supreme Court's decision in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981)). That is, outside counsel asserted that it warned the CFO that it represented the corporation, anything said by the CFO to the attorneys would be protected by the company's attorney-client privilege (subject to waiver of that privilege in the sole discretion of the company), and that the CFO might wish to consult with his own attorney if he had any concerns about his own potential legal exposure.

   The district court apparently did not believe that outside counsel, in fact, gave this warning. The Ninth Circuit refused to treat this finding by the district court as clearly erroneous. The district court concluded that the CFO had a reasonable belief that the law firm was representing not only the corporation, but also the CFO individually. The Ninth Circuit accepted the district court's determination in this regard, but concluded that the statements made by the CFO to outside counsel were nonetheless not privileged under federal law. That was because the statements could not have been made in confidence, but rather were instead for the purpose of disclosure to the company's outside auditors (which the CFO could not credibly claim he did not understand). The court said as the CFO of a large, sophisticated publicly-traded company, the defendant could not credibly claim ignorance of the general disclosure requirements imposed on a publicly-traded company with respect to its outside auditors or of the need to truthfully report corporate information to the SEC.

The district court was so troubled by the actions of outside counsel that it referred the firm to the California State Bar for possible discipline. The Ninth Circuit did not decide whether outside counsel's conduct was unprofessional, but did conclude that even if it were, this would not result in suppression in the criminal matter against the CFO of the evidence collected by outside counsel during its interview. The court also swept aside the CFO's argument that he had not understood the nature of the disclosures to be made to the auditors, and that he would not have provided the information had he known it could be used in support of a criminal investigation or an SEC enforcement action. The court said the CFO's alleged lack of understanding mattered not at all. The salient point was that the CFO understood that the information he communicated to outside counsel would be provided to third party auditors, which meant there was no communication made in confidence.

The district court later acquitted the former CFO, and dismissed with prejudice the criminal indictment in *U.S. v. Nicholas*, 2009 U.S. Dist. LEXIS 117895 (C.D. Cal. 2009). Several weeks later, the SEC announced that it would not further pursue backdating charges against the former CFO and CEO, nor would it pursue such charges against two other Broadcom executives. *SEC v. Nicholas*, No. 8:08-cv-00539-CJC-RNB (C.D. Cal. 2/4/10).

3. **<u>Counsel Did Not Represent Outside Consultant Who Was Functional Equivalent of Employee</u>**. The Ninth Circuit concluded that a corporation can enjoy privilege with respect to communications its attorneys have with consultants who are the "functional equivalent" of employees. *U.S. v. Graf*, 610 F.3d 1148 (9th Cir. 2010). In reaching this conclusion, the court was required to consider whether the company's counsel had inadvertently come to represent the consultant himself. More generally, the Ninth Circuit adopted a rule for determining when an employee, or the functional equivalent of an employee, enjoys a personal attorney-client privilege for his or her communications with a company's corporate counsel.

The privilege issues arose in the criminal trial of the founder of a corporation who was technically not an employee. The founder sought to exclude testimony of the corporation's counsel. At least ostensibly, the founder was a consultant to the company, having been prohibited from acting as an employee or agent by the terms of California cease-and-desist orders relating to earlier misconduct.

The court concluded that the defendant (the founder of the company) had no attorney-client relationship with the company's attorneys, and therefore had no privilege he could assert. Since this conclusion did not seem to depend on whether the company had privilege, one might argue that the court did not need to reach that issue. Nonetheless, the court plainly addressed the question. Specifically, the court held that the company had privilege for its counsel's communications with the founder because the founder, as a consultant, was a "functional employee" of the company. The company waived its privilege so its attorneys could testify in the founder's criminal trial, against the founder's wishes.

In concluding that the company had privilege with respect to its counsel's communications with the founder, the Ninth Circuit adopted the Eighth Circuit's analysis in *In re Bieter Co.*, 16 F.3d 929 (8th Cir. 1994). In *Bieter*, the Eighth Circuit relied on the Supreme Court's decision in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981), to apply privilege to communications between corporate counsel and outside consultants. The Ninth Circuit described *Bieter* as follows:

> The *Bieter* court reasoned that "too narrow a definition of 'representative of the client' will lead to attorneys not being able to confer confidentially with nonemployees who, due to their relationship to the client, possess the very sort of information that the privilege envisions flowing most freely." *Id.* The consultant at issue in *Bieter* was "involved on a daily basis with the principals of Bieter and on Bieter's behalf in the unsuccessful development that serve[d] as the basis for th[e] litigation," therefore, he was "precisely the sort of person with whom a lawyer would wish to confer confidentially in order to understand Bieter's reasons for seeking representation." *Id*. at 938 (citing *Upjohn*, 449 U.S. at 389). The court concluded that "he was in all relevant respects the functional equivalent of an employee." *Id.* (citing *McCaugherty v. Siffermann*, 132 F.R.D. 234, 239 (N.D. Cal. 1990)).

Graf not only addressed a corporation's privilege for communications between its counsel and non-employees who are the "functional equivalent" of employees, it also announced a standard for determining whether a corporate employee holds a joint privilege over communications with corporate counsel. This question of joint privilege seems tantamount to the question whether corporate counsel, intentionally or not, has come to represent an employee (or functional employee) in addition to representing the corporation.

Graf is illustrative of a tension inherent in representing an entity – the need to communicate through the entity's constituents, without coming to represent the constituents themselves. Given the fundamental nature of this conflict, it is worth describing the facts of the case and the court's analysis in further detail.

The defendant, Mr. Graf, was the founder of, and ostensible consultant to, a company that purported to provide health care benefits coverage to more than 20,000 plan members. In fact, the company was, as the court put it, "part of an elaborate scheme to defraud" individuals and small businesses who purchased health plan coverage through the company.

Graf was indicted for his involvement in the fraudulent operation of the company. The district court allowed several attorneys who had represented the company to testify against Graf at his criminal trial, despite Graf's motion to exclude their testimony. The district court found that the attorneys represented only the company and that Graf had no individual attorney-client relationship to establish any privilege that would be violated by the proffered testimony.

A jury found Graf guilty of conspiracy, mail fraud, misappropriation, conducting unlawful monetary transactions, and obstruction of justice. Graf was sentenced to 300 months' imprisonment, and ordered to provide restitution in an amount exceeding $20 million.

The Ninth Circuit was asked to consider whether the district court's refusal to exclude the attorneys' testimony was erroneous. The question was made complicated by the fact that Graf had not been listed as an employee, officer, or director of the company, nor of 16 related trade associations. This was so even though Graf had organized the company and the trade associations with his then-girlfriend and one other individual. As the court noted, the failure to list Graf as an employee, officer, or director was "likely because Graf had previously been banned from insurance work in the state of California for misconduct in violation of state insurance laws."

The plans were multiple employer welfare arrangements ("MEWAs") marketed to insurance agents, who in turn sold them to employers and individuals. Graf misrepresented to the insurance agents and the public that the plans were insured through various insurance companies. In making these misrepresentations, Graf ignored advice of the company's attorneys that the marketing of the plans violated state and federal law.

Graf also incorporated another company, created to appear as a preferred provider organization. This allowed Graf and his then-girlfriend to "funnel money" from the main company into the ersatz PPO in exchange for services the phony PPO allegedly rendered to the main company. This second organization was actually a shell company designed to hide the diversion of about $750,000 in premiums Graf and his then-girlfriend used to purchase jewelry, a sports car, and a house.

When the Department of Labor began investigating the main company, Graf obstructed that investigation in a variety of ways. For example, Graf instructed attorneys representing the company to inform the Department that the marketing of the plans had ceased, even though Graf knew this was false. He also told the company's employees to hide documents and information from DOL investigators conducting an onsite visit. When the DOL issued subpoenas to the second company (the one intended to appear as a PPO), Graf produced documents that purported to show that the company was in fact a PPO (run by his girlfriend), and that it provided services to the main company, although Graf knew this was false.

The DOL filed a civil suit to remove Graf and his girlfriend from the company, install an independent fiduciary to operate the company, and freeze the company's assets, as well as the personal assets of Graf and his girlfriend. The district court did, in fact, install an independent fiduciary and froze the assets of the two companies, the trade associations, and those of Graf and a business associate.

Sadly, the company collected about $14 million in payments for medical coverage, but paid less than $1.8 million in claims. Unpaid claims exceeded $20 million.

The independent fiduciary waived the company's attorney-client privilege with regard to all communications between the company and its legal counsel – both its general counsel and outside counsel. As noted earlier, Graf argued that he was a joint holder of the attorney-client privilege and had not waived it, so the testimony of these attorneys should be excluded.

The court noted that a party asserting attorney-client privilege has the burden of establishing both the existence of an attorney-client relationship and the privileged nature of the communication, citing *U.S. v. Ruehle*, 583 F.3d 600, 607 (9th Cir. 2009) (quoting *U.S. v. Bauer*, 132 F.3d 504, 507 (9th Cir. 1997)). Because the privilege "impedes full and free discovery of the truth," the privilege, the court explained, is strictly construed.

The Ninth Circuit indicated that it applies the following eight-part analysis in determining whether information is covered by the attorney-client privilege: (1) where legal advice of any kind is sought (2) from a professional legal advisor in his or her capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his or her instance permanently protected (7) from disclosure by him or herself or by the legal advisor, (8) unless the protection is waived. (Citing *U.S. v. Ruehle*, *supra*, which in turn quoted *In re Grand Jury Investigation*, 974 F.2d 1068, 1071 n. 2 (9th Cir. 1992))

Graf argued that even if, as the government asserted, the company enjoyed privilege with respect to its attorneys' communications with the company's officers, directors, and employees, Graf was not an officer, director, or employee, but was instead an outside consultant.

The court said there appeared to be two potential consequences of Graf's status as an independent consultant. First, Graf argued that because he was not an employee his conversations with the company's attorneys should not have fallen within the company's corporate privilege under the Supreme Court's decision in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981). Second, Graf contended that because he was an independent but interested or related third party, he was a joint client of the attorneys.

The court's obligation to address the first of these arguments – that because Graf was not an employee his conversations with the attorneys should not have fallen within the company's corporate privilege – may explain why the court bothered to consider whether the company had privilege. After all, the company waived any privilege it may have had, so one might think the only relevant question was whether Graf himself had privilege. For Graf to have privilege he would have needed to have been a client of the attorneys, but this would not seem to require that the company also have privilege.

In any event, the court did take the opportunity to consider both (1) whether a company's corporate attorney-client privilege extends to communications between its counsel and outside consultants, and (2) when corporate employees themselves have attorney-client privilege for communications with a corporation's counsel.

As to the first of these questions – whether a company's corporate attorney-client privilege extends to communications between the company's counsel and the company's outside consultants – the court first reminded the reader of the Supreme Court's holding in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981). In *Upjohn*, the Supreme Court held that a corporation's privilege extends to communications between corporate employees and corporate counsel as long as the communications are "made at the direction of corporate superiors in order to secure legal advice." The Ninth Circuit then adopted the Eighth Circuit's conclusion in *Bieter*, *supra*, that communications between an outside consultant and an entity's attorneys will be covered under the entity's attorney-client privilege where the outside consultant is the "functional equivalent of an employee."

The Ninth Circuit held that Graf was a "functional employee" of the company. He was a functional employee by reason of his communications with insurance brokers and agents on behalf of the company, his management of company employees, and more importantly, his role as the company's primary agent in its communications with corporate counsel. The sole reason Graf was not explicitly a director, officer, or employee was, again, apparently because outstanding California cease-and-desist orders prevented him from lawfully being employed by an insurance company in the state. Because Graf was a functional employee, and not an independent outside consultant to the company, the court rejected Graf's claim of entitlement to a <u>jointly-held</u> attorney-client privilege with the company's attorneys.

Having concluded that Graf did not have a jointly-held attorney-client privilege with the company, the court turned to the question of whether Graf, as a functional employee of the company, held a <u>personal</u> attorney-client privilege over any of his communications with the attorneys. The court announced in this regard that it was adopting the Third Circuit's test in *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 805 F.2d 120 (3d Cir. 1986) for determining whether individual employees enjoy a personal attorney-client privilege for their communications with a company's corporate counsel.

Under the *Bevill* test, which has also been adopted by the First, Second, and Tenth Circuits, individual corporate officers or employees seeking to assert a personal claim of attorney-client privilege must affirmatively show the following five factors:

> *First*, they must show they approached counsel for the purpose of seeking legal advice. *Second*, they must demonstrate that when they approached counsel they made it clear that they were seeking legal advice in their individual rather than in their representative capacities. *Third*, they must demonstrate that the counsel saw fit to communicate with them in their individual capacities, knowing that a possible conflict could arise. *Fourth*, they must prove that their conversations with counsel were confidential. And *fifth*, they must show that the substance of their conversations with counsel did not concern matters within the company or the general affairs of the company.

Bevill at 123, 125 (quoting *In re Grand Jury Investigation*, 575 F. Supp 777, 780 (N.D. Ga. 1983) (brackets omitted and emphases added).

In describing its reason for adopting the *Bevill* test, the court said the following:

> There are strong policy reasons to adopt the *Bevill* test. As noted above, any time a corporation retains counsel, counsel will have to talk to individual employees to represent the company effectively. The *Bevill* test responds to this reality by ensuring that a corporation is free to obtain information from its officers, employees, and consultants about company matters and then control the attorney-client privilege, waiving it when necessary to serve corporate interests. The test also preserves the individual's ability to claim a personal attorney-client privilege when the individual makes clear he or she is seeking personal legal advice and the communications relate to personal legal affairs, not to the company's business. Moreover, there are reasons to look to other circuits when contemplating the proper standard to this arena. As the Supreme Court cautioned in *Upjohn*, "[a]n uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all." 449 U.S. at 393. For these reasons, we adopt the *Bevill* test in the Ninth Circuit.

The court explained how the *Bevill* test would apply to Graf. For Graf to enjoy a personal attorney-client privilege, Graf must establish the following:

> (1) he approached the attorneys for the purpose of seeking legal advice; (2) when he did so, he made it clear to the attorneys that he was seeking legal advice in his individual rather than in his representative capacity; (3) the attorneys saw fit to represent him personally, knowing a conflict could arise; (4) his conversations with the attorneys were in confidence; and (5) "the substance of [his] conversations with [the attorneys] did not concern matters within [the company] or the general affairs of [the company].

The court concluded that Graf failed to meet factors 2, 3, and 5 as to all of the attorneys at issue. In reaching this conclusion, the court placed weight on the fact that the attorneys' retainer agreements and engagement letters were signed by one of the company's founders other than Graf, and that the company paid the attorneys' bills.

The court concluded that Graf had not sought any personal legal advice from the attorneys. Instead, his conversations with counsel had related to his official duties at the company and the general affairs of the company.

One attorney had previously represented Graf in an unrelated matter covering a completely different subject matter. Specifically, the attorney had represented another Graf company in connection with a potential acquisition of an insurance company. The company related to the instant litigation had, in contrast, hired the attorney's firm to review insurance policies the company planned to use in connection with its welfare program, and to determine whether those policies met federal and state law requirements. Although there was some disagreement about whether the attorney had represented Graf personally during the earlier representation of Graf's prior company, the court assumed for purposes of its opinion that he had done so. The attorney ultimately did not testify at trial, but the court indicated that there had been no personal representation of Graf because the two representations were different and were separated by several years.

As to conversations between Graf and the company's general counsel, Graf was not personally represented by that attorney while he served as general counsel (a position he held for only six months or so). The attorney did, though, represent Graf personally both before and after he was general counsel. The court said Graf presented no evidence that he ever asked the attorney to represent him personally while he was serving as general counsel, or that the attorney agreed to dual-representation after considering the potential conflicts. The attorney had previously represented Graf in an individual capacity on a variety of matters, including family law, bankruptcy, and business matters related to the California Department of Insurance's investigation of Graf's prior company. None of these personal matters was, however, legally or factually related to the matters the attorney handled at the company while serving as its general counsel. After the company was shut down by the Department of Labor, the attorney again advised Graf, this time regarding complaints he was drafting *pro se* against representatives of the Department. In indicating that he did not represent Graf personally while engaged as general counsel, the attorney not only said he did not discuss with Graf any personal liability during that time, he also testified with refreshing candor that he did "exceptionally little" as general counsel.

In adopting the *Bevill* factors, the court appears to have rejected application of an alternate test for determining whether Graf had a personal attorney-client privilege. Under that alternate theory, Graf argued that he had a "reasonable subjective belief that the company's attorneys represented him in his individual capacity." Although not entirely clear, the court seems to have adopted the five-part *Bevill* test for claiming a personal attorney-client privilege to <u>the exclusion</u> of this alternate theory.

C. **<u>"Up the Ladder" Reporting</u>**. The Model Rules address an attorney's obligations where a constituent has taken action (or refused to act) in a fashion that constitutes a violation of the law. Model Rule 1.13(b) and (c). Under Model Rule 1.13, if an attorney knows that an officer, employee, or other person associated with a client organization is, in a matter related to the representation, acting, intending to act, or refusing to act, in a fashion that is a violation of a legal obligation to the organization or a violation of law that might reasonably be imputed to the organization, and if the violation is likely to result in substantial injury to the organization, the attorney must proceed "as is reasonably necessary in the best interest of the organization." Unless the attorney reasonably believes it is not necessary in the best interest of the organization to do so, the attorney must refer the matter to higher authority in the organization, which may, if warranted by the circumstances, be the highest authority within the organization. For attorneys who advise issuers under the federal securities laws, the Sarbanes-Oxley Act may also mandate "up the ladder" reporting of material violations of federal or state securities or fiduciary duty laws to the issuer's audit committee, if the issuer's chief legal officer or chief executive officer does not respond appropriately. 17 CFR §§ 205.2(a)(1)(iii) and 205.3(b).

III. <u>Representing Multiple Parties</u>.

It is not unusual for counsel in ERISA litigation to represent multiple parties. For example, a single firm may represent an employer (which may be a fiduciary), as well as constituent directors, officers, or other employees (who may also be fiduciaries, for example, as plan committee members). A firm's ability to represent multiple parties will be subject to the normal conflict of interest rules. Under Model Rule 1.7, a conflict will exist not only where the clients are directly adverse, but also where there is a significant risk that the representation of one or more clients will be "materially limited" by the attorney's responsibilities to another client, a former client, or a third person. Where there is a such a conflict, an attorney may represent multiple clients only if, among other requirements, the attorney reasonably believes he or she will be able to provide competent and diligent representation to each affected client and each client gives "informed consent, confirmed in writing."

Counsel for an employer was disqualified in an action the employer brought in its capacity as plan sponsor of its profit sharing plan in *Pressman-Gutman Co., Inc. v. First Union National Bank*, 2004 WL 2743582, 34 EBC 1915, *reconsideration denied*, 2004 WL 2980403 (E.D. Pa. 2004), *stay denied*, 2005 WL 174848 (E.D. Pa. 2005). The employer had sued the plan's trustee and an investment advisor, alleging fiduciary breaches in connection with certain financial losses. The trustee, in response, filed a third party complaint against certain officers of the employer, asserting that the plan's financial losses were a consequence of their own breaches of fiduciary duty. A single law firm attempted to represent both the plan and the officers. (The court, in its decision, frequently refers to the law firm as representing the "plan," even though the action seems to have been brought by the plan sponsor-employer, on behalf of the plan.) Because the law firm did, in fact, represent the officers for some initial period of time, and because those same officers hired the law firm to serve as counsel for the employer and were the sole persons providing the law firm with direction in the employer's prosecution of the lawsuit, the court concluded that the law firm not only could not represent the officers individually, it was also disqualified from representing the plan (because of the firm's duty of loyalty to the officers it previously represented). The court concluded that this conflict resulting from initial representation of the officers could interfere with the plan's ability to seek recovery from the officers for any breaches of fiduciary duty the officers may have committed.

Participants in a General Motors pension plan were unsuccessful in seeking to disqualify a law firm from representing both General Motors and its plan in *Edgin v. Cobb*, 2008 WL 2858741 (E.D. Mich. 2008). The participants, who were plaintiffs in the litigation, were incarcerated as prisoners in Michigan state correctional facilities. Acting pursuant to a court order, the GM plan sent a number of the participants' pension checks to the prisons in which they were incarcerated. The State of Michigan then confiscated 90 percent of those pension payments, pursuant to the state's State Correctional Facilities Reimbursement Act. Pursuant to the state law, Michigan had a practice of seeking orders from state circuit courts directing inmates to change the address at which they receive benefits to effectuate the deposit of those benefits in the inmates' prison accounts. In particular, when an inmate failed or refused to make a change of address, the state would seek (and be granted) an order by a state trial court directing the trustee or fiduciary of the pension plan to deposit funds to which the inmate was entitled into the inmate's prison account. These court orders appointed the warden of the prison facility as receiver of the funds. The orders then directed the warden to pay 90 percent of the deposited funds to the state, as called for under the state law.

This process of seeking court orders had been challenged a number of times. In an appeal of one of those orders, the Supreme Court of Michigan held that the depositing of a prisoner's monthly pension checks in his or her prison account was not an assignment of the prisoner's pension benefits and, therefore, did not constitute a violation of ERISA. Later, however, the Sixth Circuit, in *DaimlerChrysler v. Cox*, 447 F.3d 967 (6th Cir. 2006), *cert. denied*, 127 S. Ct. 2971 (2007), in a case substantially identical to the case previously decided by the Supreme Court of Michigan, held that the forced forwarding of a prisoner's pension checks to his prison address violated ERISA's anti-alienation provisions. The state court orders and wardens' notices issued pursuant to the statute were, therefore, preempted by ERISA. Following the Sixth Circuit's decision, General Motors sought and was granted a declaratory judgment holding that the orders to send pension benefits to an address or account other than as designated by the participant were preempted.

The plaintiffs sued GM and its plan, seeking damages for breaches of fiduciary duties and common law negligence. The plaintiffs claimed that the pension plan fiduciaries failed to act to defend their rights to receive their pension benefits and that they should have known that the orders issued pursuant to the state law were of questionable legality and enforceability in light of prior rulings and precedents defining the prohibitions against alienation of benefits.

In refusing to disqualify a law firm from representing both GM and its plan, the federal district court indicated that, to its knowledge, Michigan's conflict of interest rule for attorneys had never been successfully invoked to prevent defense counsel from representing both a pension plan and the sponsoring employer in an ERISA suit. In fact, the court concluded that both the terms of ERISA and various Supreme Court decisions contemplate the possibility of an employer acting both as plan administrator and sponsor of a plan, and that any possible conflicts resulting from an employer both controlling and funding a plan are permissible. The court therefore concluded that it is reasonable for an attorney to assume that he or she can fairly represent both a plan and the sponsoring employer in litigation, especially when both are named defendants to plan participants' claims. The court also observed that because the plan and the company had acted in "relative concert" with regard to the participant's pension benefits and with regard to their reactions to the various court decisions dealing with the state law at issue, if either defendant were at fault it was very probable both were at fault. This bolstered the court's conclusion that there was no conflict of interest between the company and its plan that would disqualify defense counsel from representing either or both defendants in the litigation.

The trustee of an ESOP was unsuccessful in disqualifying plaintiffs' counsel in a class action against the trustee for breach of fiduciary duty, where the trustee argued it had disclosed confidential information to plaintiffs' counsel in unrelated litigation that could be unfairly used against the trustee in the present action. *Summers v. UAL Corporation ESOP Committee*, 2004 WL 2583877, 34 EBC 1949 (N.D. Ill. 2004). The trustee, State Street Bank & Trust Company ("State Street"), contended that prior to the instant litigation it served as an independent fiduciary for certain Enron plans, and in that connection had entered into a joint prosecution agreement with plaintiffs' counsel to ensure that confidential information exchanged with State Street in litigation concerning the Enron plans would be protected. State Street claimed that for two years its supplied plaintiffs' counsel with confidential information that included how State Street complies with its fiduciary duties as a trustee of retirement plans that invest in employer securities, what State Street believes its fiduciary duties are when it serves as a directed trustee of an ERISA plan with company stock investments, and State Street's strategies in prosecuting the action against the Enron defendants, including the directed trustee. State Street argued that plaintiffs' counsel in the subject class action against State Street (as trustee for a plan for employees of United Airlines) had, thereby, gained special insights into State Street's fiduciary practices and procedures, which made it inappropriate for the firm to serve as plaintiffs' counsel. State Street argued, in part, that in the Enron litigation there was an implied attorney-client relationship between State Street and plaintiffs' counsel under the prosecution agreement, even though there was no such express relationship. State Street seemed to argue that, as a result, there was an implied professional relationship which would make it appropriate to apply a rule akin to Model Rule 1.9, under which an attorney that formerly represented a client in a matter may be prohibited from representing an adverse party in a "substantially related matter." The court refused to disqualify plaintiffs' counsel, in part because it concluded that State Street had failed to point to any past or present confidential information that was at risk of misuse by counsel in the instant action.

Both plaintiff and defense counsel were disqualified in *Niagara-Genesee & Vicinity Carpenters Local 280 v. United Brotherhood of Carpenters & Jointers of America*, 843 F. Supp. 855 (W.D. N.Y. 1994) and *Niagara-Genesee & Vicinity Carpenters Local 280 v.*

United Brotherhood of Carpenters & Joiners of America, 859 F. Supp. 65 (W.D. N.Y. 1994). Plaintiff counsel for ousted union officers (who had been pension fund trustees by reason of their status as union officers) was disqualified because (a) the ousted union officers were suing new union officers who had replaced them as trustees, and (b) the attorney's partner was counsel to the pension fund (though not in the instant litigation). In disqualifying the attorney, the court seemed to impute to him the conflicts of the attorney's partner. The court stated that the pension fund's counsel could not align himself with the old trustees because by doing so he would be "improperly representing the interests of some of the Fund participants and beneficiaries against the interests of others," and instead had a "fiduciary responsibility to represent the interests of *all* the beneficiaries." In addition, defense counsel for the new union officers (and trustees) was disqualified because that firm also represented the local union. Representation of the local created a conflict because, as counsel to the local, the firm's "allegiance is to the local as an entity, and thus to all of its members." Similarly, the court stated that counsel's "role must be to keep paramount the interests of the organization as a whole, and not to align itself with any individual or faction."

The Fifth Circuit concluded that there was no impermissible conflict of interest for purposes of establishing a prohibited transaction under ERISA where attorneys at a law firm provided advice to a profit sharing plan, while other attorneys in the same firm provided very "limited" services to a plan participant in connection with a qualified domestic relations order. *Hatteberg v. RedAdair Co., Inc. Employees' Profit Sharing Plan and its Related Trust*, 79 Fed. Appx. 709, 2003 WL 22510848, 32 EBC 1755 (5th Cir. 2003) (unpublished). A participant's former spouse filed suit claiming a variety of fiduciary breaches, including an assertion that plan fiduciaries engaged in a prohibited transaction by hiring counsel from the same law firm that represented the participant in the plaintiff's divorce. The court quickly concluded that the law firm had no conflict of interest, and that there was, therefore, no prohibited transaction. Although the action did not involve a claim for violation of the attorneys' professional standards, but instead an allegation that retention of the law firm to provide advice to the plan was a prohibited transaction under ERISA, the district court concluded that there was no evidence the law firm had an ethical (or legal) conflict of interest in its representation. The Fifth Circuit seemed tacitly to approve this conclusion about the applicable ethical standards.

A federal district court rejected an attempt to disqualify attorneys in a 401(k) fee class action in *Abbott v. Lockheed Martin Corp.*, 2009 U.S. Dist. LEXIS 62778 (S.D. Ill. 2009). The defense argued that plaintiffs' law firm should be disqualified because the firm was operating under a conflict of interest impermissible under the rules applicable to class counsel. In particular, the defendants argued that plaintiffs' counsel was acting in violation of Federal Rules of Civil Procedure 23(g)(1)(B) and (4), which require, in part, that class counsel "fairly and adequately represent the interests of the class." Fed. R. Civ. P. 23(g)(1)(B).

The allegations concerned plaintiffs' counsel's efforts in seeking disclosure of documents received by the defendant-employer from 401(k) recordkeeping vendors, in response to the employer's requests for proposal. The defendants had, through an RFP, solicited confidential bids from these prospective recordkeeping candidates. The defendants asserted that confidentiality was critical because the technical capabilities of the potential providers, and their underlying cost structures, were considered by the vendors to be closely guarded secrets. Because of the sensitivity of this proprietary information, the defendants acceded to the vendors' demands that they enter into confidentiality agreements.

The defendants argued that for plaintiffs' counsel to seek confidential information about the candidates' responses was contrary to the interest of the law firm's clients (the plan participants). That was because disclosing the documents could derail the process for obtaining lower recordkeeping fees, and this would be to the detriment of those participant-clients. The defendants claimed plaintiffs' counsel sought the public disclosure of the defendants' bid-related documents not to benefit their clients in the case at hand, but instead to enhance the litigation posture of the law firm's other clients in unrelated cases by "expos[ing] the excessiveness of fees paid by 401(k) plans of other corporate defendants, including those defendants in similar ERISA fee cases."

The court rejected the request to disqualify plaintiffs' counsel, concluding that there was "no doubt" the firm had "vigorously" represented the class in the past, and the expectation was that it would continue to do so. The court said the defendants failed to identify any actual conflict between the plaintiff class in the current action and any other representation by the law firm that was "inescapably adverse." Instead, the defendants' contention that the law firm was attempting to make public confidential documents for the purpose of advantaging plaintiffs in other cases, to the detriment of the class in the current case, did not "rise above the level of speculative or hypothetical."

A federal district court rejected defense counsel's attempt to disqualify counsel representing plaintiffs, where the plaintiffs allegedly had opposing interests to one another. *Marks Constr. Co. v. Huntington Nat'l Bank*, 2010 U.S. Dist. LEXIS 32998 (N.D. W.Va. 2010). The plaintiffs were the plan sponsor of a 401(k) plan (that also served as plan administrator and a named fiduciary), two individuals acting for the company in matters relating to administration of the plan, and two individual plan participants. The defendant was a bank.

The action involved the employer's conversion of its 401(k) arrangement from a "managed plan" (this apparently meant participants did not choose how the monies in their accounts were invested, but instead those decisions were made for all participants by a fiduciary) to a participant-directed plan. The plaintiffs alleged that the bank (and an individual defendant) improperly liquidated the investments of the plan without authorization and without regard to gain or loss, failed to prudently reinvest plan assets after liquidating the investments of the plan, and received excessive and unreasonable compensation from the plan and the plan's participants, apparently all in connection with the plan conversion.

The essence of the defendants' argument was that if, as the plaintiffs asserted, these actions involved breaches of fiduciary duty and prohibited transactions, some of the plaintiffs would also be among the fiduciaries responsible for the losses and therefore liable to the plan. They would then be liable indirectly to plan participants, which would include two of their co-plaintiffs. The defendants asserted that this created an unwaivable conflict under the West Virginia Rules of Professional Conduct.

The court rejected the defendants' attempt to disqualify plaintiffs' counsel for several independent reasons. First, the court seemed to reject the notion that some of the plaintiffs (the employer and the two individuals acting for the employer in connection with the administration of the plan) would have liability to the plan, and therefore indirectly to two of their co-plaintiffs. (The determination of the plaintiffs' potential liability would never actually be made because the parties agreed to a settlement prior to the court ruling on the motion to disqualify.) As to the employer-plaintiff's decision to approve the conversion from a managed plan to a participant-directed plan, the court seemed to conclude that it was a settlor, not fiduciary decision, so none of the plaintiffs could be subject to fiduciary liability for that decision. As to the defendants' argument that if they were blameworthy in charging unreasonable and excessive fees, this would also create liability for the employer and the two individuals acting on behalf of the employer, because they would have violated their fiduciary duties by retaining the bank and signing a document approving the bank's fees and expenses, the court said if it accepted this argument the logical extension would be that any fiduciary could shift blame for any possible alleged misconduct to the plan sponsor simply for hiring them. Although this may not necessarily be the case – that is, one could imagine liability for both a fiduciary breaching its duties and the fiduciary retaining that fiduciary (for making an imprudent hire) – the court more cogently stated that the plaintiffs' allegations were that the bank's services were "inadequate and unauthorized" and that the fees were not fully disclosed, neither of which would necessarily reflect poorly on the employer or other fiduciaries retained by the bank.

The second ground on which the court rejected the attempt to disqualify plaintiffs' counsel was that the motion to disqualify had been brought too late. It was brought more than four years after the action had been removed to federal court. The court thought the defendants should have understood from early on the nature of the conflict they alleged. In a helpful string cite, the court noted a number of cases denying motions to disqualify counsel as untimely, where the delay in filing the motion after suit was brought ranged from as little as 13 months to two or three years. As to the ability of the defendants to raise the issue at all (since they were not clients aggrieved by the conflict), the court noted that a movant may raise the question of a conflict where the "conflict is such as clearly to call in question the fair or efficient administration of justice." The court said the defendants did not meet this burden.

The third alternative ground on which the court rejected the motion to disqualify was that even if there were a conflict, it was waivable, and the court accepted the plaintiffs' counsel's assertion that it had secured both oral and written waivers for any potential conflict of interest.

Attorneys who provide regular representation to fiduciaries face a special risk under Model Rule 3.7. Under that rule, an attorney may not "act as advocate in litigation if he or she is "likely to be a necessary witness" unless "(1) the testimony relates to an uncontested issue; (2) the testimony relates to the nature and value of legal services rendered in the case; or (3) disqualification of the lawyer would work substantial hardship on the client." In particular, where an attorney may be required to testify regarding trustee meetings or advice provided to plan fiduciaries, the attorney may be required to withdraw from acting as an advocate, although this disqualification should not prevent other attorneys in the same firm from providing representation. Model Rule 3.7(b).

A. **Dual Role of In-House Counsel.** The Third Circuit, in upholding a denial of severance benefits to an employee who was terminated from his sales position for allegedly falsifying call data, commented on the role of in-house counsel in representing both the company in human resources matters and the company's "employee benefits committee" in benefits matters. *Estate of Schwing v. Lilly Health Plan*, 562 F.3d 522, 46 EBC 2370 (3d Cir. 2009). The employer's fiduciary committee, its "Employee Benefits Committee" or "EBC," determined that the employee was ineligible for severance benefits because he was terminated for misconduct. Both the employee's supervisor and a representative from the company's human resources department told the EBC that the employee had admitted his misconduct, although the employee denied this admission and argued that he had been terminated not for the alleged misconduct but instead either as a result of mistakes or in retaliation for a grievance he filed several years earlier.

The court applied the Supreme Court's standard of review announced in *Metropolitan Life Ins. Co. v. Glenn*, 128 Sup. Ct. 2343 (2008), and concluded that the EBC's decision to deny benefits was not an abuse of discretion (and therefore should not be overturned). The court rejected the employee's argument that the EBC should have conducted an independent investigation into the veracity of the accounts presented to the committee. In doing so, the court found that the EBC conducted an appropriate investigation, stating that there is no requirement that an ERISA plan administrator faced with an issue of who is to be believed conduct an independent investigation into the veracity of each account. The court found the administrative record that had been developed, and that was before the district court, to have been more than adequate to support the EBC's denial of the employee's claim.

In upholding the benefit denial, the court reversed the district court's decision. The district court not only found that the EBC failed to adequately investigate the employee's claim (which argument the Third Circuit rejected), but also that the EBC's decision was tainted by a conflict of interest. There were, in fact, two alleged conflicts of interest. One was the type of structural conflict at issue in *Glenn*, where a committee comprising employees was deciding a claim under a plan the employer was responsible for funding. But there was also a second alleged conflict of interest which the district court seemed to find notable. This concerned the role of an attorney who was both associate counsel for the employer and counsel to the EBC. It appears that this in-house attorney may have had a role in the decision to terminate the employee's employment, and may also have participated in the presentation of the employee's severance claim to the EBC. The court rejected the notion that this alleged conflict of interest would serve as a basis for a conclusion that the EBC had abused its discretion in denying benefits. In applying the *Glenn* "combination-of-factors" analysis, the court found that there was an abundance of evidence concerning the employee's misconduct to support the benefit denial, and a lack of evidence to support the employee's theory of pretext. For that reason, any purported conflict of interest would not have been so substantial as to change the result. But the court went further by approving the attorney's role with respect to the EBC. In that regard, the court said the following:

> The attorney's role vis-à-vis the EBC was advisory only and her conduct, although criticized by the [district court], was altogether appropriate. We note that ERISA fiduciaries are not required to engage independent counsel to aid in their interpretation and administration of an ERISA plan, and we note our disagreement with the [district court's] conclusion, based on certain cases interpreting the attorney client privilege, that an attorney for an ERISA fiduciary owes a fiduciary-like duty of neutrality to each ERISA claimant. (citations omitted)

B. **<u>Confidentiality as Between Clients</u>**. Under Model Rule 1.6, absent an agreement between co-clients, an attorney normally may not reveal confidential information to a co-client. Joint representation agreements may, however, provide for such sharing of confidences. The commentary to the Model Rule states as follows:

> As to the duty of confidentiality, continued common representation will almost certainly be inadequate if one client asks the lawyer not to disclose to the other client information relevant to the common representation. . . . The lawyer should, at the outset of the common representation and as part of the process of obtaining each client's informed consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other.

Model Rule 1.7, cmt. [31].

The Restatement, in contrast to the Model Rules, presumes that information will be shared among co-clients unless the co-clients explicitly agree otherwise. Restatement § 60, cmt. l. Where one client requests that material information be withheld from a co-client, and the co-clients have not explicitly agreed to restrict information from one another, the attorney will then be required to withdraw due to a conflict of interest. *Id.*

IV. **Attorney-Client Privilege**.

The determination of who an attorney represents is, of course, fundamental in understanding the scope of any attorney-client privilege. Absent a client's informed consent, the Model Rules prohibit an attorney from revealing information relating to representation of a client. Model Rule 1.6. The comments to Model Rule 1.6 indicate that an attorney *must* invoke attorney-client privilege when it is applicable. Model Rule 1.6, cmts. [2] and [4].

According to the Restatement, attorney-client privilege may be invoked with respect to "(1) a communication (2) made between privileged persons (3) in confidence (4) for the purpose of obtaining or providing legal assistance for the client." Restatement § 68. There can be no privilege unless an attorney-client relationship exists. Importantly, to be privileged a communication must be made in confidence and for the purpose of obtaining legal advice. *See, e.g., Hudson v. General Dynamics*, 186 F.R.D. 271 (D. Conn. 1999) (questionnaire responses provided by early retirees in their capacity as witnesses were not made for the purpose of obtaining legal advice, and therefore were not privileged); *Byrnes v. Empire Blue Cross Blue Shield*, 1999 U.S. Dist. LEXIS 17281 (S.D. N.Y. 1999) (only those memoranda exchanged by an actuarial firm, an employer's attorney, and the employer that were prepared to assist the attorney in rendering legal advice were privileged; those meant to aid the employer's business decisions were not privileged); *Neuder v. Battelle Pacific Northwest National Laboratory*, 194 F.R.D. 289 (D. D.C. 2000) (documents prepared in connection with a meeting of employer's personnel review committee were not privileged, even though in-house counsel participated in the meetings; where business and legal advice are intertwined, the legal advice must predominate for the communication to be protected; court found that in-house counsel was serving as a member of the committee in a nonlegal capacity); *Aiena v. Olsen*, 194 F.R.D. 134 (S.D. N.Y. 2000) (letters to insurer's counsel sent by individuals charged with violating ERISA, for the purpose of convincing the insurer of its obligation to provide indemnification and bear the cost of the individual's defense, were not privileged because they were not for the purpose of obtaining legal advice or for use by potential future defense counsel; instead, insureds were seeking counsel of their own choice and agreed the carrier had a conflict of interest prohibiting it from defending them). Notably, in *Lewis v. UNUM Corp. Severance Plan*, 203 F.R.D. 615 (D. Kan. 2001), discussions among committee members while considering a beneficiary's claims were not privileged, despite the attendance of counsel, to the extent communications with counsel were not for the purpose of obtaining legal advice, nor did privilege attach to the members' opinions, impressions, or conclusions based upon events occurring during the meeting.

Where attorney-client communications are privileged, the privilege runs only to the communications themselves, not to the underlying information communicated. That is, a party is not precluded by the attorney-client privilege from discovering information through an alternate path, which does not involve compelling disclosure of communication with an attorney. *Wachtel v. Health Net, Inc.*, 482 F.3d 225, 237-38, 40 EBC 1545 (3d Cir. 2007), *citing Upjohn Co. v. United States*, 449 U.S. 383, 395 (1981).

A. **<u>Attorney's Retention of Consultant: Privilege for Client's Communications With Consultant</u>**. Attorney-client privilege relates, of course, to a client's communications with its (or his or her) attorney. It generally does not extend to a client's communications with the client's accountants or plan vendors, such as benefit consultants, actuaries, recordkeepers, or third party administrators. That is so even though there may, in some jurisdictions or in certain circumstances, be some privilege other than attorney-client privilege, perhaps for communications between a client and its accountant or under federal tax rules for certain advice sought from a non-attorney tax professional.

There can be an exception to this lack of privilege for communications with non-attorneys where legal counsel has employed or retained the non-lawyer to help understand a legal matter about which the client has sought advice. This exception arises under a hoary Second Circuit decision, *U.S. v. Kovel*, 296 F.2d 918 (2d Cir. 1961). Under the so-called *Kovel* doctrine, a client's communications with a non-attorney can be privileged, even though they would not have been privileged had the communications been directly between the client and the non-attorney without the non-attorney first having been retained by counsel.

The contours of the *Kovel* doctrine are not at all clear. That is because rather than announce a clear formulation for determining when attorney-client privilege extends to a client's communications with a consultant, the court in *Kovel* described its holding in more contextual terms. In *Kovel*, an accountant employed by a law firm specializing in tax law was sentenced for criminal contempt for refusing to answer a question asked in the course of an inquiry by a grand jury. It appears the accountant was not simply retained by the law firm as a consultant, but was instead an actual employee of the firm.

The grand jury was investigating alleged federal income tax violations by a client of the law firm. The accountant was subpoenaed to appear and asked to testify about various discussions and communications with this firm client. The accountant refused to answer. He was held in contempt and sentenced to three years imprisonment. On appeal, the Second Circuit vacated the judgment and remanded the matter for further consideration. (The remand was a consequence of the circuit court not having adequate facts to resolve the matter on its merits.)

The Second Circuit framed the issue very nicely. It said the question was "under what circumstances, if any, the attorney-client privilege may include a communication to a non-lawyer by the lawyer's client." Relying heavily on Wigmore's treatise on evidence, the court concluded that although an attorney's retention of a non-lawyer does not automatically confer privilege on a client's communications with that non-lawyer, when the attorney needs the assistance of another to understand matters, the client's communications with the non-lawyer providing that assistance may enjoy attorney-client privilege. In reaching this conclusion, the court relied heavily on an analogy to an attorney's use of a foreign language translator. The court thought it clear that if an attorney needed to retain a translator in representing a client who spoke a foreign language, the communications between the client and the interpreter should be privileged.

The court cautioned that simply retaining a non-lawyer does not result in communications with the non-lawyer being privileged. But where a party is necessary to aid the attorney in handling his or her legal work, a client's communications with that party should enjoy privilege. The court put it this way:

> Nothing in the policy of the [attorney-client] privilege suggests that attorneys, simply by placing accountants, scientists or investigators on their payrolls and maintaining them in their offices, should be able to invest all communications by clients to such persons with a privilege the law has not seen fit to extend when the latter are operating under their own steam. On the other hand, in contrast to the Tudor times when the privilege was first recognized, the complexities of modern existence prevent attorneys from effectively handling clients' affairs without the help of others; few lawyers could now practice without the assistance of secretaries, file clerks, telephone operators, messengers, clerks not yet admitted to the bar, and aides of other sorts. "The assistance of these agents being indispensable to his work and the communications of the client being often necessarily committed to them by the attorney or by the client himself, the privilege must include all the persons who act as the attorney's agents." (Footnotes and citations omitted.)

In introducing the foreign language translator analogy, the court said the following:

> [T]he Government does not here dispute that the privilege covers communications to non-lawyer employees with "a menial or ministerial responsibility that involves relating communications to an attorney." We cannot regard the privilege as confined to "menial or ministerial" employees. Thus, we can see no significant difference between a case where the attorney sends a client speaking a foreign language to an interpreter to make a literal translation of the client's story; a second where the attorney, himself having some little knowledge of the foreign tongue, has a more knowledgeable non-lawyer employee in the room to help out; a third where someone to perform that same function has been brought along by the client; and a fourth where the attorney, ignorant of the foreign language, sends the client to a non-lawyer proficient in it, with instructions to interview the client on the attorney's behalf and then render his own summary of the situation, perhaps drawing on his own knowledge in the process, so that the attorney can give the client proper legal advice. All four cases meet every element of Wigmore's famous formulation, §

> 2292, "(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived," save (7); literally, none of them is within (7) since the disclosure is not sought to be compelled from the client or the lawyer. Yet § 2301 of Wigmore would clearly recognize the privilege in the first case and the Government goes along to that extent; § 2301 would also recognize the privilege in the second case and § 2311 in the third unless the circumstances negated confidentiality. We find no valid policy reason for a different result in the fourth case, and we do not read Wigmore as thinking there is. Laymen consulting lawyers should not be expected to anticipate niceties perceptible only to judges -- and not even to all of them.

Applying the translator analogy to the client's communications with the accountant– and more generally, one assumes, to other experts necessary for an attorney to do his or her job (and in particular to those required for the attorney to understand technical materials that may be necessary to provide representation) – the court said the following:

> This analogy of the client speaking a foreign language is by no means irrelevant to the appeal at hand. Accounting concepts are a foreign language to some lawyers in almost all cases, and to almost all lawyers in some cases. Hence the presence of an accountant, whether hired by the lawyer or by the client, while the client is relating a complicated tax story to the lawyer, ought not destroy the privilege, any more than would that of the linguist in the second or third variations of the foreign language theme discussed above; **the presence of the accountant is necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit**. By the same token, if the lawyer has directed the client, either in the specific case or generally, to tell his story in the first instance to an accountant engaged by the lawyer, who is then to interpret it so that the lawyer may better give legal advice, communications by the client reasonably related to that purpose ought fall within the privilege; there can be no more virtue in requiring the lawyer to sit by while the client pursues these possibly tedious preliminary conversations with the accountant than in insisting on the lawyer's physical presence while the client dictates a statement to the lawyer's secretary or in interviewed by a clerk not yet admitted to practice. What is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer. If what is sought is not legal advice but only

> accounting service, as in *Olender v. United States, 210 F.2d 795, 805-806* (9 Cir. 1954), see *Reisman v. Caplin, 61-2 U.S.T.C. P9673 (1961)*, or if the advice sought is the accountant's rather than the lawyer's, no privilege exists. (Emphasis added; footnotes omitted.)

Importantly, the court noted that for a client's communications with a non-lawyer to enjoy attorney-client privilege, legal counsel must <u>first</u> retain the non-attorney. So, the order in which matters occur is important. The court anticipated criticism of this conclusion that there can be privilege only where the attorney is retained first (and the attorney then retains the non-attorney), saying:

> We recognize this draws what may seem to some a rather arbitrary line between a case where the client communicates first to his own accountant (no privilege as to such communications, even though he later consults his lawyer on the same matter, *Gariepy v. United States, 189 F.2d 459, 463* (6th Cir. 1951)), and others, where the client in the first instance consults a lawyer who retains an accountant as a listening post, or consults the lawyer with his own accountant present. But that is the inevitable consequence of having to reconcile the absence of a privilege for accountants and the effective operation of the privilege of client and lawyer under conditions where the lawyer needs outside help. (Footnotes omitted)

For benefits lawyers, the salient points in the *Kovel* court's discussion are that (1) the attorney needs to have been hired in the matter prior to the client communicating with the non-attorney (and perhaps that the attorney, rather than the client, have hired the non-attorney), and (2) the non-attorney probably needs to be "necessary, or at least highly useful, for the effective consultation between the client and the lawyer which the privilege is designed to permit." Let's apply this second point to the benefits practice. Although one assumes a client's discussions with a pension or health plan actuary would not normally enjoy privilege, there may be circumstances where those communications will be privileged, particularly if the actuary is instead first retained by the client's legal counsel. Consider, for example, a client that retains an attorney to evaluate (a) whether ERISA's minimum funding requirements have been met for its defined benefit pension plan, and (b) the consequences for the client should those standards not have been met. The attorney may well need the services of an actuary to properly understand the various steps required to determine whether the minimum funding standards have been met. If, for that reason, the attorney retains an actuary, and thereafter the client has discussions with the actuary, one could argue those discussions would be privileged under *Kovel*. A harder question may be whether the actuary can be the regular plan actuary with whom the client has previously communicated on unrelated, similar, or the same issue, and whether privilege will extend to future communications on those same issues if they relate to the attorney's engagement.

The *Kovel* doctrine seems to arise most commonly where either a plan sponsor or plan fiduciary wishes to engage a party to do a compliance audit. The client could, of course, engage a law firm to handle the audit. But if the client were instead to turn to a benefits consulting firm or other non-lawyer vendor to evaluate the sponsor's (or fiduciary's) compliance with ERISA, the Tax Code, and other legal requirements, there may be value in having legal counsel for the client engage the party, rather than the plan sponsor or fiduciary doing so directly.

Whether the resulting communications between the client and the party handling the compliance review would then enjoy attorney-client privilege would seem a more difficult issue than in the example above where an attorney who was asked about minimum funding requirements retains an actuary. That is because some of the work handled by the compliance audit vendor will very likely fall within the capabilities of the attorney. In the parlance of *Kovel*, there would be no need for a "translator" with respect to much of the information gathered. There would, though, be exceptions, where it would be necessary, or at least highly useful, for the attorney to have experts knowledgeable in actuarial science, finance, medicine, or intellectual technology, "translate" for the attorney.

But even if the attorney has the skill set to do the entire audit, recall that *Kovel*, in *dicta*, noted that attorneys cannot do their work effectively without the assistance of helpers having non-technical abilities, such as "secretaries, file clerks, telephone operators, messengers, clerks not yet admitted to the bar, and aides of other sorts." The court quoted Wigmore to the effect that "the assistance of these agents being indispensible to his work, . . . the privilege must include all the persons who act as the attorney's agents." One could argue, then, that if an attorney has been retained to pull together and analyze the results of a compliance audit vendor's efforts, and uses those results in providing a report to the client involving legal (rather than business) analysis, having the compliance audit vendor report its results to the attorney (and perhaps even having the attorney retain that vendor) may well extend attorney-client privilege to the client's communications with the non-attorney vendor.

It would seem that the role of the attorney must be meaningful, though. That is, *Kovel* imagines a circumstance where an attorney has been asked for legal advice. The attorney gathers assistance from others in providing that advice. The attorney is, of course, the party that provides the legal advice to the client. If, instead, an attorney were engaged simply to serve as a conduit for the compliance audit vendor's report, receiving and passing it along to the client, and perhaps for the purpose of retaining the vendor, it would seem hard to argue that the client's communications with the vendor would enjoy attorney-client privilege under *Kovel*. That is because if the attorney's only role is to "touch" the vendor's report as it passes to the client (and perhaps to retain the vendor), the attorney would not seem to have been retained to provide any meaningful legal analysis for which the attorney would have needed the assistance of the compliance audit vendor.

All of this begs the question whether the "fiduciary exception" to attorney-client privilege described in Section IV.D below makes all this moot. Where the matters at issue are fiduciary, rather than settlor, in nature there would typically be no privilege in any event, unless the "personal liability" rule described in Section IV.F below applies. There is no reason to think the *Kovel* doctrine somehow bootstraps one out of the fiduciary exception, creating privilege where none would otherwise have existed. In the examples above, involve funding and compliance audits, there may, depending on the facts and circumstances, be some argument that the personal liability rule applies or that some or all of the issues are settlor.

Disclosure to Actuary. In *Cottillion v. United Refining Co.,* 2011 U.S. Dist. LEXIS 151519, 53 EBC 1275 (W.D. Pa. 2011), a federal district court considered a dispute concerning an actuarial reduction in early retirement benefits. As to the inapplicability of the fiduciary exception for advice concerning personal liability (see the *U.S. v. Mett* discussion in Section IV.F below), the court held that the interest of the plan beneficiaries diverged from the plan trustee's interest when the trustee took concrete steps to actuarially reduce benefits to retirees already in pay status and to recoup overpayments, because at that point a serious and significant threat of litigation had materialized. An attorney's action in copying an actuary on an email did not waive attorney-client privilege because the actuary's involvement was at the direction of the attorney, to assist the attorney in the provision of legal advice. As to whether a disclosure to the actuary constitutes a waiver, the court said the critical inquiry is "whether the third party consultant is involved in the giving of legal advice" or "functions like an employee in providing information which facilitates the obtaining of legal advice." The key in the instant case was that the communications with the actuary were at the attorney's direction, for the express purpose of assisting him in providing legal advice.

An email from the actuary to a committee member regarding recouping payments was not, however, privileged, even if it was at the attorney's direction because it concerned only accounting issues related to the administration of the plan (and was prepared for non-litigation purposes, not in anticipation of litigation).

The court also concluded as follows:

1. A draft document subject to revision was not automatically privileged.

2. A proposed response to an inquiry from a beneficiary relating to a reduction in benefits enjoyed no privilege because it was related only to plan administration.

3. A draft form of a letter to participants regarding a benefit reduction in a VCP process was related to administration of the plan, and therefore not privileged.

4. Discussions of plan amendments concerned settlor issues, so the fiduciary exception was inapplicable.

5. Meeting minutes generally were not privileged, except small portions containing legal advice falling within the personal liability limitations of the fiduciary exception.

The court also concluded that letters to auditors relating to the annual plan audit were not privileged.

B. **Entity Representation**. Generally, an entity client will enjoy attorney-client privilege with respect to communications between its attorney and its constituents, so long as those communications relate to the subject matter of the representation. *Upjohn Co. v. United States*, 449 U.S. 383 (1981); Restatement § 73 & cmt. d. To enjoy privilege, the communication must, however, be with an "agent" of the entity, which can include even lower level employees communicating with counsel concerning the subject matter of the representation.

Corporation's Privilege for Communications With Outside Consultant Who Was Functional Equivalent of Employee. The Ninth Circuit concluded that a corporation can enjoy privilege with respect to communications its attorneys have with consultants who are the "functional equivalent" of employees. *U.S. v. Graf*, 610 F.3d 1148 (9th Cir. 2010). The issue arose in the criminal trial of the founder of a corporation who was technically not an employee. The founder sought to exclude testimony of the corporation's counsel. At least ostensibly, the founder was a consultant to the company, having been prohibited from acting as an employee or agent by the terms of California cease-and-desist orders relating to earlier misconduct.

The court concluded that the defendant (the founder of the company) had no attorney-client relationship with the company's attorneys, and therefore had no privilege he could assert. Since this conclusion did not seem to depend on whether the company had privilege, one might argue that the court did not need to reach that issue. Nonetheless, the court plainly addressed the question. Specifically, the court held that the company had privilege for its counsel's communications with the founder because the founder, as a consultant, was a "functional employee" of the company. The company waived its privilege so its attorneys could testify in the founder's criminal trial, against the founder's wishes.

In concluding that the company had privilege with respect to its counsel's communications with the founder, the Ninth Circuit adopted the Eighth Circuit's analysis in *In re Bieter Co.*, 16 F.3d 929 (8th Cir. 1994). In *Bieter*, the Eighth Circuit relied on the Supreme Court's decision in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981), to apply privilege to communications between corporate counsel and outside consultants. The Ninth Circuit described *Bieter* as follows:

> The *Bieter* court reasoned that "too narrow a definition of 'representative of the client' will lead to attorneys not being able to confer confidentially with nonemployees who, due to their relationship to the client, possess the very sort of information that the privilege envisions flowing most freely." *Id.* The consultant at issue in *Bieter* was "involved on a daily basis with the principals of Bieter and on Bieter's behalf in the unsuccessful development that serve[d] as the basis for th[e] litigation," therefore, he was "precisely the sort of person with whom a lawyer would wish to confer confidentially in order to understand Bieter's reasons for seeking representation." *Id*. at 938 (citing *Upjohn*, 449 U.S. at 389). The court concluded that "he was in all relevant respects the functional equivalent of an employee." *Id.* (citing *McCaugherty v. Siffermann*, 132 F.R.D. 234, 239 (N.D. Cal. 1990)).

Graf not only addressed a corporation's privilege for communications between its counsel and non-employees who are the "functional equivalent" of employees, it also announced a standard for determining whether a corporate employee holds a joint privilege over communications with corporate counsel. This question of joint privilege seems tantamount to the question whether corporate counsel, intentionally or not, has come to represent an employee (or functional employee) in addition to representing the corporation.

Graf is illustrative of a tension inherent in representing an entity – the need to communicate through the entity's constituents, without coming to represent the constituents themselves. Given the fundamental nature of this conflict, it is worth describing the facts of the case and the court's analysis in further detail.

The defendant, Mr. Graf, was the founder of, and ostensible consultant to, a company that purported to provide health care benefits coverage to more than 20,000 plan members. In fact, the company was, as the court put it, "part of an elaborate scheme to defraud" individuals and small businesses who purchased health plan coverage through the company.

Graf was indicted for his involvement in the fraudulent operation of the company. The district court allowed several attorneys who had represented the company to testify against Graf at his criminal trial, despite Graf's motion to exclude their testimony. The district court found that the attorneys represented only the company and that Graf had no individual attorney-client relationship to establish any privilege that would be violated by the proffered testimony.

A jury found Graf guilty of conspiracy, mail fraud, misappropriation, conducting unlawful monetary transactions, and obstruction of justice. Graf was sentenced to 300 months' imprisonment, and ordered to provide restitution in an amount exceeding $20 million.

The Ninth Circuit was asked to consider whether the district court's refusal to exclude the attorneys' testimony was erroneous. The question was made complicated by the fact that Graf had not been listed as an employee, officer, or director of the company, nor of 16 related trade associations. This was so even though Graf had organized the company and the trade associations with his then-girlfriend and one other individual. As the court noted, the failure to list Graf as an employee, officer, or director was "likely because Graf had previously been banned from insurance work in the state of California for misconduct in violation of state insurance laws."

The plans were multiple employer welfare arrangements ("MEWAs") marketed to insurance agents, who in turn sold them to employers and individuals. Graf misrepresented to the insurance agents and the public that the plans were insured through various insurance companies. In making these misrepresentations, Graf ignored advice of the company's attorneys that the marketing of the plans violated state and federal law.

Graf also incorporated another company, created to appear as a preferred provider organization. This allowed Graf and his then-girlfriend to "funnel money" from the main company into the ersatz PPO in exchange for services the phony PPO allegedly rendered to the main company. This second organization was actually a shell company designed to hide the diversion of about $750,000 in premiums Graf and his then-girlfriend used to purchase jewelry, a sports car, and a house.

When the Department of Labor began investigating the main company, Graf obstructed that investigation in a variety of ways. For example, Graf instructed attorneys representing the company to inform the Department that the marketing of the plans had ceased, even though Graf knew this was false. He also told the company's employees to hide documents and information from DOL investigators conducting an onsite visit. When the DOL issued subpoenas to the second company (the one intended to appear as a PPO), Graf produced documents that purported to show that the company was in fact a PPO (run by his girlfriend), and that it provided services to the main company, although Graf knew this was false.

The DOL filed a civil suit to remove Graf and his girlfriend from the company, install an independent fiduciary to operate the company, and freeze the company's assets, as well as the personal assets of Graf and his girlfriend. The district court did, in fact, install an independent fiduciary and froze the assets of the two companies, the trade associations, and those of Graf and his girlfriend.

Sadly, the company collected about $14 million in payments for medical coverage, but paid less than $1.8 million in claims. Unpaid claims exceeded $20 million.

The independent fiduciary waived the company's attorney-client privilege with regard to all communications between the company and its legal counsel – both its general counsel and outside counsel. As noted earlier, Graf argued that he was a joint holder of the attorney-client privilege and had not waived it, so the testimony of these attorneys should be excluded.

The court noted that a party asserting attorney-client privilege has the burden of establishing both the existence of an attorney-client relationship and the privileged nature of the communication, citing *U.S. v. Ruehle*, 583 F.3d 600, 607 (9th Cir. 2009) (quoting *U.S. v. Bauer*, 132 F.3d 504, 507 (9th Cir. 1997)). Because the privilege "impedes full and free discovery of the truth," the privilege, the court explained, is strictly construed.

The Ninth Circuit indicated that it applies the following eight-part analysis in determining whether information is covered by the attorney-client privilege: (1) where legal advice of any kind is sought (2) from a professional legal advisor in his or her capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his or her instance permanently protected (7) from disclosure by him or herself or by the legal advisor, (8) unless the protection is waived. (Citing *U.S. v. Ruehle, supra*, which in turn quoted *In re Grand Jury Investigation*, 974 F.2d 1068, 1071 n. 2 (9th Cir. 1992))

Graf argued that even if, as the government asserted, the company enjoyed privilege with respect to its attorneys' communications with the company's officers, directors, and employees, Graf was not an officer, director, or employee, but was instead an outside consultant.

The court said there appeared to be two potential consequences of Graf's status as an independent consultant. First, Graf argued that because he was not an employee his conversations with the company's attorneys should not have fallen within the company's corporate privilege under the Supreme Court's decision in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981). Second, Graf contended that because he was an independent but interested or related third party, he was a joint client of the attorneys.

The court's obligation to address the first of these arguments – that because Graf was not an employee his conversations with the attorneys should not have fallen within the company's corporate privilege – may explain why the court bothered to consider whether the company had privilege. After all, the company waived any privilege it may have had, so one might think the only relevant question was whether Graf himself had privilege. For Graf to have privilege he would have needed to have been a client of the attorneys, but this would not seem to require that the company also have privilege.

In any event, the court did take the opportunity to consider both (1) whether a company's corporate attorney-client privilege extends to communications between its counsel and outside consultants, and (2) when corporate employees themselves have attorney-client privilege for communications with a corporation's counsel.

As to the first of these questions – whether a company's corporate attorney-client privilege extends to communications between the company's counsel and the company's outside consultants – the court first reminded the reader of the Supreme Court's holding in *Upjohn Co. v. U.S.*, 449 U.S. 383 (1981). In *Upjohn*, the Supreme Court held that a corporation's privilege extends to communications between corporate employees and corporate counsel as long as the communications are "made at the direction of corporate superiors in order to secure legal advice." The Ninth Circuit then adopted the Eighth Circuit's conclusion in *Bieter, supra*, that communications between an outside consultant and an entity's attorneys will be covered under the entity's attorney-client privilege where the outside consultant is the "functional equivalent of an employee."

The Ninth Circuit held that Graf was a "functional employee" of the company. He was a functional employee by reason of his communications with insurance brokers and agents on behalf of the company, his management of company employees, and more importantly, his role as the company's primary agent in its communications with corporate counsel. The sole reason Graf was not explicitly a director, officer, or employee was, again, apparently because outstanding California cease-and-desist orders prevented him from lawfully being employed by an insurance company in the state. Because Graf was a functional employee, and not an independent outside consultant to the company, the court rejected Graf's claim of entitlement to a <u>jointly-held</u> attorney-client privilege with the company's attorneys.

Having concluded that Graf did not have a jointly-held attorney-client privilege with the company, the court turned to the question of whether Graf, as a functional employee of the company, held a <u>personal</u> attorney-client privilege over any of his communications with the attorneys. The court announced in this regard that it was adopting the Third Circuit's test in *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 805 F.2d 120 (3d Cir. 1986) for determining whether individual employees enjoy a personal attorney-client privilege for their communications with a company's corporate counsel.

Under the *Bevill* test, which has also been adopted by the First, Second, and Tenth Circuits, individual corporate officers or employees seeking to assert a personal claim of attorney-client privilege must affirmatively show the following five factors:

> *First*, they must show they approached counsel for the purpose of seeking legal advice. *Second*, they must demonstrate that when they approached counsel they made it clear that they were seeking legal advice in their individual rather than in their representative capacities. *Third*, they must demonstrate that the counsel saw fit to communicate with them in their individual capacities, knowing that a possible conflict could arise. *Fourth*, they must prove that their conversations with counsel were confidential. And *fifth*, they

> must show that the substance of their conversations with counsel did not concern matters within the company or the general affairs of the company.

Bevill at 123, 125 (quoting *In re Grand Jury Investigation*, 575 F. Supp 777, 780 (N.D. Ga. 1983) (brackets omitted and emphases added).

In describing its reason for adopting the *Bevill* test, the court said the following:

> There are strong policy reasons to adopt the *Bevill* test. As noted above, any time a corporation retains counsel, counsel will have to talk to individual employees to represent the company effectively. The *Bevill* test responds to this reality by ensuring that a corporation is free to obtain information from its officers, employees, and consultants about company matters and then control the attorney-client privilege, waiving it when necessary to serve corporate interests. The test also preserves the individual's ability to claim a personal attorney-client privilege when the individual makes clear he or she is seeking personal legal advice and the communications relate to personal legal affairs, not to the company's business. Moreover, there are reasons to look to other circuits when contemplating the proper standard to this arena. As the Supreme Court cautioned in *Upjohn*, "[a]n uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all." 449 U.S. at 393. For these reasons, we adopt the *Bevill* test in the Ninth Circuit.

The court explained how the *Bevill* test would apply to Graf. For Graf to enjoy a personal attorney-client privilege, Graf must establish the following:

> **(2)** he approached the attorneys for the purpose of seeking legal advice; (2) when he did so, he made it clear to the attorneys that he was seeking legal advice in his individual rather than in his representative capacity; (3) the attorneys saw fit to represent him personally, knowing a conflict could arise; (4) his conversations with the attorneys were in confidence; and (5) "the substance of [his] conversations with [the attorneys] did not concern matters within [the company] or the general affairs of [the company].

The court concluded that Graf failed to meet factors 2, 3, and 5 as to all of the attorneys at issue. In reaching this conclusion, the court placed weight on the fact that the attorneys' retainer agreements and engagement letters were signed by one of the company's founders other than Graf, and that the company paid the attorneys' bills.

The court concluded that Graf had not sought any personal legal advice from the attorneys. Instead, his conversations with counsel had related to his official duties at the company and the general affairs of the company. One attorney had previously represented Graf in an unrelated matter covering a completely different subject matter. Specifically, the attorney had represented another Graf company in connection with a potential acquisition of an insurance company. The company related to the instant litigation had, in contrast, hired the attorney's firm to review insurance policies the company planned to use in connection with its welfare program, and to determine whether those policies met federal and state law requirements. Although there was some disagreement about whether the attorney had represented Graf personally during the earlier representation of Graf's prior company, the court assumed for purposes of its opinion that he done so. The attorney ultimately did not testify at trial, but the court indicated that here had been no personal representation of Graf because the two representations were different and were separated by several years.

As to conversations between Graf and the company's general counsel, Graf was not personally represented by that attorney while he served as general counsel (a position he held for only six months or so). The attorney did, though, represent Graf personally both before and after he was general counsel. The court said Graf presented no evidence that he ever asked the attorney to represent him personally while he was serving as general counsel, or that the attorney agreed to dual-representation after considering the potential conflicts. The attorney had previously represented Graf in an individual capacity on a variety of matters, including family law, bankruptcy, and business matters related to the California Department of Insurance's investigation of Graf's prior company. None of these personal matters was, however, legally or factually related to the matters the attorney handled at the company while serving as its general counsel. After the company was shut down by the Department of Labor, the attorney again advised Graf, this time regarding complaints he was drafting *pro se* against representatives of the Department. In indicating that he did not represent Graf personally while engaged as general counsel, the attorney not only said he did not discuss with Graf any personal liability during that time, he also testified with refreshing candor that he did "exceptionally little" as general counsel.

In adopting the *Bevill* factors, the court appears to have rejected application of an alternate test for determining whether Graf had a personal attorney-client privilege. Under that alternate theory, Graf argued that he had a "reasonable subjective belief that the company's attorneys represented him in his individual capacity." Although not entirely clear, the court seems to have adopted the five-part *Bevill* test for claiming a personal attorney-client privilege to <u>the exclusion</u> of this alternate theory.

<u>Privilege Over Pre-Merger Communications with Target Company May Pass to Surviving Corporation in Merger</u>. In a case of first impression involving the interpretation of a Delaware statutory provision concerning corporate mergers, the Delaware Court of Chancery concluded that, absent a contractual language to the contrary in the merger agreement, privilege over pre-merger communications with a target company belonged to the survivor as a matter of law under Section 259 of the General Corporation Law of the State of Delaware. *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 70 A.3d 155 (Del. Ch. 2013).

C. **<u>Multiple Representation</u>**. Although attorney-client privilege may be waived by disclosure to third parties, confidential communications between joint clients and their attorney are privileged as to third parties, and those communications may be disclosed to the other client without waiving confidentiality. Restatement § 75(1). Where co-clients' communications with their attorney relate to "matters of common interest," the attorney may disclose those communications to other co-clients unless the clients have agreed to the contrary. Restatement § 75(2).

D. **<u>Fiduciary Exception</u>**. In general, to the extent an attorney advises (1) a fiduciary (2) about a matter dealing with the administration of an employee benefit plan, the attorney's client for privilege purposes is not the fiduciary personally but, rather, the trust's beneficiaries. *Washington-Baltimore Newspaper Guild, Local 35 v. Washington Star Co.*, 543 F. Supp. 906, 3 EBC 1741 (D. D.C. 1992). Some courts have concluded that this "fiduciary exception" to the attorney-client privilege applies only where there is "good cause" for requiring disclosure to participants (or to the Department of Labor, representing the participants' interests). Courts requiring "good cause" have been influenced by the Fifth Circuit's decision in *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), where the court required a corporation to disclose information to its shareholders in connection with a shareholder action for fraud where there was good cause to deny privilege. See, for example, *Thompson v. Avondale Industries, Inc.*, 2001 U.S. Dist. LEXIS 15674 (E.D. La. 2001), where the court indicated that the parties "acknowledge[d] the applicability of *Garner*." The court in *Thompson* refused to apply an exception to the attorney-client privilege because the plaintiff ESOP participants seeking discovery held only a small portion of the company's outstanding stock, the plaintiffs did not establish that the information sought could not be obtained by other means, and the discovery sought was overbroad. Though not entirely clear, the court in *Donovan v. Fitzsimmons*, 90 F.R.D. 583, 2 EBC 1393 (N.D. Ill. 1981), seemed to assume that participants must show good cause to discover communications between an attorney and a fiduciary.

Other courts have not applied the *Garner* analysis in the ERISA fiduciary context. Instead, they have reached the conclusion that a fiduciary has no privilege *vis a vis* participants, without requiring that participants show good cause for the disclosure. For example, no good cause showing was required in *Washington-Baltimore Newspaper Guild, Local 35 v. Washington Star Co.*, 543 F. Supp. 906, 3 EBC 1741 (D. D.C. 1992); and *Martin v. Valley National Bank*, 140 F.R.D. 291 (S.D. N.Y. 1991), *summary judgment granted sub nom Reich v. Valley National Bank*, 837 F. Supp. 1259 (S.D. N.Y. 1993). Some courts have failed to impose a good cause requirement without squarely addressing the applicability of *Garner*. *E.g., Jackson v. Capital Bank & Trust Co.,* 1991 WL 148751 (E.D. La. 1991);

Hammond v. Trans World Airlines, 1991 WL 93498 (N.D. Ill. 1991); and *Petz v. Ethan Allen, Inc.*, 113 F.R.D. 494 (D. Conn. 1985). In other cases, courts have determined that good cause existed, without determining whether good cause was required. E.g., *Helt v. Metropolitan District Commission*, 113 F.R.D. 7, 7 EBC 2617 (D. Conn. 1986). In *Wildbur v. Arco Chemical Co.,* 974 F.2d 631, 16 EBC 1235 (5th Cir.), *reh'g denied,* 979 F.2d 1013, 16 EBC 1251 (5th Cir. 1992), the Fifth Circuit found that attorney-client privilege protected communications between a fiduciary and litigation counsel because litigation counsel had advised the fiduciary for the purpose of defending the instant lawsuit "and did not deal with plan administration."

DOL Audit: Fiduciary Exception. The Fourth Circuit held that the fiduciary exception applies not only where the Department of Labor acts on behalf of beneficiaries in an enforcement action, but also to a Department of Labor compliance investigation under ERISA Section 504. *Solis v. Food Employers Labor Relations Assn.*, 644 F.3d 221, 50 EBC 2697 (4th Cir. 2011).

E. **Nonfiduciary Matters**. The fiduciary exception does not apply to overcome claims of privilege where the client was not acting in a fiduciary capacity[1] with respect to the communications at issue. *See, e.g., In re Unisys Corp. Retiree Medical Benefits ERISA Litigation*, 1994 WL 6883 (E.D. Pa. 1994) (employer's communication with counsel would be privileged to the extent it related to decision to amend or terminate employee benefit plan). Similarly, in *In re Long Island Lighting Co.*, 129 F.3d 268, 21 EBC 2025 (2d Cir. 1997), a fiduciary enjoyed privilege with respect to communications concerning nonfiduciary matters (such as "settlor functions" like amending or terminating a plan), even though other communications with the same attorney relating to plan administration may not have been privileged.

Where an employer was unable to demonstrate that documents related "*solely* to its nonfiduciary activities or to the formation, amendment, or termination of [its] pension plan" and could not establish that the documents were "wholly unrelated to plan administration and have not been used in connection with defendants' role as plan administrator," the plan sponsor did not enjoy privilege *vis a vis* plan participants. *Everett v. USAir Group, Inc.,* 165 F.R.D. 1 (D. D.C. 1995) (emphasis added). The court in *Everett* did, however, recognize that when a plan sponsor can demonstrate that it has consulted an attorney on issues other than plan

1 In the privilege context, some courts seem to treat the term "plan administration" (as used in *Washington Star* and its progeny) as describing precisely those actions that are "fiduciary" – as opposed to "settlor" – in nature (a fiduciary/non-fiduciary distinction was applied in *In re Long Island Lighting Co.* and a number of subsequent decisions). *But see Fischel v. Equitable Life Assurance,* 191 F.R.D. 606 (N.D. Cal. 200), where the court was careful to note that *Mett* (and its predecessor *Washington Star*) used the term "plan administration," whereas the court in *In re Long Island Lighting* applied a fiduciary/non-fiduciary activity distinction. The court in *Fischel* rejected the fiduciary/non-fiduciary distinction, in part, because it found it difficult to apply.

administration, the sponsor, and not any beneficiary, will be the client and will be entitled to attorney-client privilege.

Advice from counsel concerning documents drafted for the purpose of communicating with participants about amendments to benefit plans related to fiduciary matters, and therefore did not enjoy privilege vis-à-vis plan participants, in *Baker v. Kingsley*, 2007 U.S. Dist. Lexis 8375 (N.D. Ill. 2007). The case is notable because it appears that the "benefits update" and "retiree medical highlights brochure" that were the subject of the discovery dispute were prepared before the formal adoption of the plan amendments they described. They were, however, prepared after the business decision to change the plans had been approved by the employer's board of directors. The employer argued that the fiduciary exception to privilege did not apply because the documents were drafted prior to the formal amendments having been adopted, and while the employer was still in the process of seeking advice from counsel on how to draft the formal plan documents. As a result, the employer argued, communications relating to the documents concerned non-fiduciary settlor functions, such as adoption or amendment of a plan. The court rejected this argument, stating that "defendants cite no authority in support of their argument that a plan needs to be in a final form in order for fiduciary obligations to arise regarding preparation of employee and retiree communications material explaining approved plan changes."

A federal district court concluded that the creation of a plan committee having responsibility for investment issues relating to 401(k) plans was not a fiduciary decision, so communications regarding the creation of the committee were privileged. *Beesley v. Int'l Paper Co.*, 2008 WL 2323849, 44 EBC 1038 (S.D. Ill. 2008). The case involved allegations by participants in 401(k) plans that the defendants were fiduciaries and had breached their fiduciary duties in various ways, including by failing to contain plan costs, paying unreasonable fees to service providers, failing to minimize costs associated with investments in employer securities, and holding a portion of plan assets in cash. The plans were, apparently, at an earlier time supervised by a group called the "fiduciary review committee," but a decision was later made to create a 401(k) committee to assume that function.

The company's Director of Trust Investments testified in a deposition that it was her understanding that the reason for removing the supervisory function from the earlier group was that "it was viewed as a conflict of interest to have directors of [the company] be responsible for decisions made with regard to the company stock so there was a decision a legal decision made to separate those two responsibilities." After the Director of Trust Investments testified that her knowledge of the alleged conflict of interest came from counsel, her attorney objected on the basis of attorney-client privilege and instructed her not to answer questions relating to the issue. Similarly, an individual who had previously served as plan administrator testified in a deposition that he was removed from his position as such after new corporate counsel reviewed the "board governance activities" and decided to make some changes. Plaintiffs' counsel attempted to ask questions about the "scope" of counsel's review, at which point defendants' counsel invoked the attorney-client privilege and instructed the witness not to answer.

The court considered whether, by reason of the fiduciary exception, the plaintiffs were entitled to ask questions of these witnesses about the reasons for the creation of the 401(k) committee, as well as the reasons the individual who had served as plan administrator was replaced in that capacity. In that regard, the defendants pointed out that the 401(k) committee was created by amendments to the relevant plans. The court said this was not dispositive of the question whether the creation of the committee was a fiduciary act (that is, a "plan administration function") because a plan administration function could not be converted into a plan amendment, and thereby become sheltered by privilege, simply by memorializing the act in a plan amendment. Instead, the court indicated that it must look to the nature of the act to determine whether the fiduciary exception applied. In this case, the nature of the act was to change the identity of the body charged with supervision and oversight of the plans at issue. The court noted that under Seventh Circuit precedent, the design of a plan is not a fiduciary function. Similarly, the decision to set up a new plan as part of a sale of the employer's assets has been held not to be a fiduciary function. More generally, fiduciary standards do not apply when an employer "decides to establish, amend, or terminate a benefits plan, as opposed to managing any assets of the plan and administering the plan in accordance with its terms." Decisions about the investment of plan money and the exercise of control over the management or disposition of plan assets do, however, constitute administration of a plan, so the fiduciary exception would apply with respect to those decisions.

After reviewing the relevant Seventh Circuit precedent, the court concluded that the decision to create the 401(k) committee constituted a plan amendment rather than plan management. As a result, communications with corporate counsel regarding the creation of the committee were privileged.

F. **Personal Liability**. In *United States v. Mett*, 178 F.3d 1058, 23 EBC 1081 (9th Cir. 1999), the Ninth Circuit considered the privileged status of communications with an attorney who represented plan fiduciaries (as well as the plan itself and the employer). The court held that any advice relating to the fiduciaries' personal liability was privileged as personal advice rather than advice concerning ongoing plan administration. Other courts, post-*Mett*, have also drawn a distinction between communications relating to plan administration and those relating to a fiduciary's personal liability. Generally, privilege attaches to communications relating to a fiduciary's personal liability, but not to communications relating to plan administration.

In the context of benefit claims, a number of courts have applied the *Mett* analysis to hold that advice provided prior to fiduciaries denying a claim is not entitled to privilege, although advice provided after a claim is denied may be privileged. *See, e.g., Geissal v. Moore Medical Corp.*, 192 F.R.D. 620, 24 EBC 2805, 27

EBC 1188 (E.D. Mo. 2000); *Lewis v. UNUM Corp. Severance Plan*, 203 F.R.D. 615 (D. Kan. 2001); *Coffman v. Metropolitan Life Insurance Co.*, 204 F.R.D. 296, 27 EBC 1188 (S.D. W.Va. 2001); *Anderson v. Sotheby's Inc. Severance Plan*, __________ (S.D.N.Y. May 13, 2005) (Case No. 04 CIV 8180 (SAS)(DFE)); *Asuncion v. Metro. Life Ins. Co.*, 493 F. Supp. 2d 716, 720-22 (S.D.N.Y. 2007); *Black v. Pitney Bowes*, 2006 U.S. Dist. LEXIS 92263 (S.D. N.Y. 2006); *Bell v. Pfizer Inc.*, 2006 U.S. Dist. LEXIS 62611 (S.D. N.Y. 2006).

One federal district court has, however, indicated that a "pre-decisional/post-decisional" approach for determining whether communications are subject to the fiduciary exception is inappropriately rigid. *Tatum v. R.J. Reynolds Tobacco Co.*, 247 F.R.D. 488, 43 EBC 2304 (M.D.N.C. 2008). The *Tatum* court instead concluded that the time period in which communications occur may be informative, but not dispositive, as to whether privilege applies. The key issue is whether the communication related to plan administration or generalized concern for liability, as opposed to concern for the fiduciaries' liability as a result of a <u>specific threat of litigation</u>. In *Tatum*, one of the plaintiffs, in complaining about the elimination of a 401(k) investment option for investing in stock of a former parent company, indicated that he had retained a lawyer and was considering a class action lawsuit. In a subsequent letter to the company's employee benefits committee, in which the participant submitted a claim for benefits, the participant alleged that the plan fiduciaries had violated their ERISA obligations and that if his claim were denied he wanted the names of the members of the committee, meeting minutes where the stock divestiture issue was discussed, and opinions of counsel relating to that divestiture.

The court found that under these circumstances, there was a concern for the fiduciaries' liability as a result of a specific threat of litigation, and that this arose even before the fiduciary committee had decided the participant's claim. That is, taking the participant's communications as a whole, it was reasonable that the defendants would have perceived the participant to be making a specific threat of litigation even before beginning the participant's administrative claim and review process. The circumstances did not reflect the generalized prospect of post-decisional litigation that may occur any time a claim is denied. Rather, the participant made specific statements indicating his intention to file suit. The participant's administrative claim for benefits, submitted "at the Plan fiduciaries' instigation," merely delayed the filing of the participant's lawsuit.

The court concluded that communications reflecting legal advice concerning how to respond to the participant's legal claim and impending litigation were privileged, even though they apparently occurred before the participant's administrative claim was decided. The court found the existence of privilege to be a closer question with respect to legal opinions and advice of outside counsel regarding the <u>response to</u> the participant's <u>administrative claim</u> and appeal. Although generally legal advice related to the ordinary administration of a plan, such as preparing a response to a beneficiary's claim, is not privileged as against the beneficiary, in the instant case the legal advice was rendered by outside litigation counsel in anticipation of the participant's impending litigation. The court was not required to make a decision with respect to this advice under the attorney-client privilege doctrine, because the defendants successfully asserted work product protection for these documents. As a result, the documents were not required to be disclosed.

In a post-*Tatum* decision, a different federal district court, citing to both *Tatum* and *Wachtel* (discussed below in the section captioned "Insurance Companies"), held that an insurance company that decided claims and paid long-term disability benefits from its own assets enjoyed privilege with respect to communications occurring after the insurance company denied a plan participant's claim and after the participant threatened the insurance company with litigation. The court found that all of the communications in dispute related to the threatened litigation. *Fortier v. Principal Life Ins. Co.*, 2008 U.S. Dist. LEXIS 43108 (E.D. N.C. 2008). The court observed, incidentally, that the Fourth Circuit has not directly addressed whether there is a fiduciary exception to attorney-client privilege in the ERISA context.

The *Tatum* analysis generally does not seem to have turned the tide from the pre-decisional/post-decisional approach (for determining whether communications are subject to the fiduciary exception). For example, a federal district court in 2009 noted approvingly the pre-decisional/post-decisional distinction, and this distinction seemed to guide the court's conclusion that certain pre-decisional communications were not privileged by reason of the fiduciary exception. *Redd v. Bhd. of Maintenance of Way Employees Div. of the Int'l Bhd. of Teamsters*, 2009 U.S. Dist. LEXIS 46288, 47 EBC 1865 (E.D. Mich. 2009). The *Redd* court cited the rationale of *Geissal*, above, in rejecting a plan administrator's argument that documents were privileged where they were created in the "pre-decisional" phase of the administrator's decision to recalculate and reduce plaintiff-participants' pension benefits. The documents apparently concerned the administrator's decision that the pension benefits had been incorrectly calculated, as well calculation of the purportedly correct amounts.

The plan administrator argued that the fiduciary exception did not apply, and the communications should therefore be privileged, in part because the participants were former employees who had already begun to receive pension benefits, so they and the plan administrator would "invariably be in an 'adversarial' posture as soon as the plan administrator commenced the inquiry whether these benefits payments were erroneous and should be recalculated." The court quoted from the *Geissal* opinion in rejecting the plan administrator's argument, noting that if the possibility that a benefit denial would lead to litigation were sufficient reason to overcome the fiduciary exception, all of the antecedent, pre-decisional legal advice of counsel in connection with any denial of a beneficiary's claim for benefits under a plan would be subject to attorney-client privilege. The court said this would "contradict[ ] the principle that the plan's administrator or trustee administers the plan in the beneficiaries' best interests."

The court continued to quote from *Geissal*, as follows:

> The prospect of post-decisional litigation against the plan by a disappointed beneficiary can exist whenever the plan denies a claim. Because the denial of claims is as much a part of the administration of a plan as the decision-making which results in no unhappy beneficiary, the prospect of post-decisional litigation against the plan is an insufficient basis for gainsaying the fiduciary exception to the attorney-client privilege.

The *Redd* court summed up its conclusion as follows:

> [E]ven if the plan administrator viewed it as likely that the recalculation of Plaintiffs' benefits would result in litigation, and even if the decision to consult with counsel was motivated in part by this likelihood of eventual litigation, this Court finds that this prospect, standing alone, is insufficient to preclude a plan beneficiary's access to pre-decisional communications between a plan administrator and counsel concerning matters of plan administration.

Redd raises a couple of other interesting issues. First, the plaintiffs argued that the "personal liability" exception to the fiduciary exception should not apply because they were making no effort to impose personal liability on the plan administrator such that the advice of counsel could be viewed "as offered on behalf of the plan administrator rather than the plan and its beneficiaries." The court did not directly address the implications of the plaintiffs' assertion, but it raises an interesting question: whether <u>post</u>-decisional communications may be privileged, or instead are subject to the fiduciary exception, where no claim is made against any party for personal liability. That, conceivably, might occur where a participant brings a claim only for benefits, and not, for example, for fiduciary breach, and where the claim is brought only against the plan administrator. One might argue that in this circumstance the relief sought is simply the payment of benefits from the plan's assets, and no party to the litigation has been threatened with personal liability. This is an interesting question, but one which the court did not address (and to which the author does not know the answer).

Second, the plan administrator in *Redd* argued that it retained privilege with respect to pre-decisional decisions (and the fiduciary exception did not apply) because at least some of the plaintiffs were not merely plan participants but, while still employed, "played roles in the administration and operation of the plan." The court concluded that this would not be sufficient to defeat application of the fiduciary exception, even though a magistrate judge had earlier apparently viewed this as a strong indication that the plan administrator's action would lead to "an adversarial situation" and later litigation. The court, in contrast, seemed to conclude that rarely, if ever, would pre-decisional communications avoid the fiduciary exception and thereby retain their status as privileged.

Another point about *Redd* bears mention. The court noted in a footnote that it had permitted discovery so plaintiffs could explore the plan administrator's possible conflicts of interest, since the court would need to take any such conflicts into account in its standard of review analysis under the Supreme Court's guidance in *Metropolitan Life Ins. Co. v. Glenn*, 128 S. Ct. 2343 (2008). Commentators had earlier observed that one of the consequences of *Glenn* might be a new judicial tolerance for discovery in benefits litigation. If so, this will make all the more important the question of when attorney-client privilege applies. Although the court concluded that pre-decisional communications were not privileged, it did express some skepticism about their relevance. In this regard, the court stated the following:

> Yet, Plaintiffs have not endeavored to explain how the requested materials might tend to shed light on the existence or nature of any such conflict of interest. Similarly, while Plaintiffs posit that Defendants might pursue an "advice of counsel" defense, this Court is not aware of any case law support for the proposition that a plan administrator's decision to deny benefits is better able to withstand judicial scrutiny if it rests upon an attorney's reading of the pertinent plan provisions.

A different federal district court concluded that the fiduciary exception to privilege did not apply where the requested discovery related to communications from counsel after plaintiffs had commenced litigation, even though the advice was provided during the course of, and relating to, the plaintiffs' administrative appeals. *Society of Professional Engineering Employees in Aerospace, IFPTE Local 2001 v. Boeing Co.,* 2009 U.S. Dist. LEXIS 102345 (D. Kan. 2009). The plaintiffs, who were participants seeking pension benefits, initiated their administrative claims for benefits under the terms of the pension plan only after filing a lawsuit in which the plaintiffs asserted that the company's Employee Benefit Plans Committee had breached its fiduciary duties to the plaintiffs.

Because of the pending litigation, the company's pension service center engaged in-house counsel to provide legal advice concerning the administrative claims. Those administrative claims were denied and the plaintiffs appealed the denials to the company's Employee Benefit Plans Committee. In doing so, the plaintiffs' appeal referred to and incorporated allegations in their complaint pending in federal district court. The Committee retained outside legal counsel to "help it navigate the unfamiliar waters where the individuals claiming benefits had already filed suit in federal court seeking the very same benefits that were the subject of their administrative claims and were asserting that the Committee had to respond to the allegations in the lawsuit in deciding the administrative appeal."

The court rejected the plaintiffs' argument that the fiduciary exception applied. The plaintiffs had asserted that the fiduciary exception applied because the plaintiffs were seeking discovery only concerning counsel's advice about plan interpretation, and not counsel's advice relating to the fiduciaries' personal liability. (Some of the requested documents related to legal advice provided in connection to the Committee's response to the plaintiffs' administrative appeal; other of the requested advice related also to the pending litigation.) The court, in concluding that the fiduciary exception did not apply, and that the requested information was protected under attorney-client privilege, said the following:

> In this case the plan fiduciary retained counsel for legal advice because plaintiffs had already commenced litigation and alleged that the Committee had breached its fiduciary duties to the beneficiaries. Because the beneficiaries initiated a suit asserting claims directly against the Committee, "the legal fiction of the 'trustee as a representative of the beneficiaries' is dispelled." See *United States v. Mett, 178 F.3d 1058, 1065 (9th Cir. 1999).* The legal advice was sought because of the pending litigation and claims of personal liability; thus, the attorney-client privilege remains intact. *Lewis [v. UNUM Corp. Severance Plan,* 203 F.R.D. 616 (D. Kan. 2001)] *at 619*.
>
> Plaintiffs argue that they seek to discover ***only*** advice on plan interpretation, not advice relating to a fiduciary's personal liability. This argument is not persuasive. The Committee secured the services of legal counsel ***because*** the litigation filed against it included a claim that the Committee breached its fiduciary duty to plaintiffs. As noted above, the legal fiction that the trustee is a representative of the plaintiff beneficiaries disappears after claims are asserted directly against the Committee. Equally important, the implied suggestion that counsel could provide meaningful legal advice to the Committee concerning personal liability without evaluating the language of the plan is simply not persuasive.[10] Accordingly, the communications with (1) in-house counsel in June and August 2007 and (2) outside counsel in November and December 2007 are protected by the attorney client privilege. Counsels' drafts and legal research during this period are also protected by the attorney work product doctrine. (Reference to amended complaint omitted)
>
> [10] Plaintiffs rely heavily on Lewis to support their claim for production. However, the legal communication ordered produced in Lewis was both "pre-decision" and "pre-litigation." Most significantly, the claim in Lewis was limited to a request for benefits under the plan. The circumstances in this case are materially different from those presented in Lewis because these consolidated lawsuits include a count against the Committee personally for breach of fiduciary duty.

In *Fischel v. Equitable Life Assurance*, 191 F.R.D. 606 (N.D. Cal. 2000), the court wrestled with whether to apply the *Mett* privilege analysis, or instead to apply what it seemed to consider to be different analysis under *In re Long Island Lighting*. The court preferred *Mett*, which it characterized as articulating the following formulation of the fiduciary exception: "that while generally, the fiduciary exception applies to matters of plan administration, the attorney-client privilege reasserts itself as to any advice that a fiduciary obtains to protect itself from liability." The court went on to say: "Another way of putting it is that *Mett* limits the scope of advice that relates to 'plan administration' by excluding from it any advice whose goal is to advise the trustee about the legal implications of actions and decisions undertaken while performing its fiduciary obligations." This latter formulation of the *Mett* analysis would seem to provide broader privilege protection than that offered under the first quote above, since advising a trustee about the legal implications of an action or decision would, at least arguably, not always be solely for the purpose of protecting the fiduciary from liability. The court criticized the analysis in *In re Long Island Lighting Co*., where the Second Circuit focused on whether communications concerned settlor functions or instead fiduciary functions. The *Fischel* court criticized this approach, in part, because of the difficulty in determining what constitutes a fiduciary function.

Applying *Mett*, the *Fischel* court concluded that privilege applied to (a) advice regarding the legal implications and potential liability for the employer and its board in amending and designing the employer's plan, and (b) documents reflecting in-house counsel's review and comments on drafts of letters responding to employees' inquiries, complaints, and claims concerning the plan. In contrast, the court held there was no privilege with respect to (a) documents reviewed by in-house counsel that were intended to describe or communicate to beneficiaries changes in plan benefits, and (b) documents in which in-house counsel had reviewed and commented on the structure and design of the employer's plan, including its compliance with the employer's statutory obligations under the federal tax code.

As to counsel's advice concerning the employer's potential liability in amending and designing the plan, that advice was privileged because the court gleaned from the subject materials that "litigation [was] anticipated, and the advice relate[d] to the potential exposure to the trustees in their personal capacity." Similarly, the review of draft letters responding to employees' inquiries and complaints was privileged because those letters were written to parties who had challenged a decision to restrict or alter benefits and the advice was rendered in anticipation of litigation. One might argue that privilege would also have applied to counsel's comments on the structure and design of the plan if the court had concluded, as did the court in *In re Long Island Lighting*, that privilege attaches to advice relating to settlor matters. The author would argue that the learning from *Mett* and *In re Long Island Lighting* should be that privilege attaches both (a) to advice that does not relate to plan administration (and does not relate to a fiduciary act or decision), *and* (b) to advice the goal of which is to advise a fiduciary about his or her potential personal liability.

In *Moss v. UNUM Life Ins. Co. of America*, 2011 U.S. Dist. LEXIS 8635, 50 EBC 1984 (W.D. Ky. 2011), a federal district court, without deciding whether insurers have greater privilege than other fiduciaries (a la *Wachtel*, noted in Section VI.H below), held that an insurer had privilege where documents were created before a final benefits determination, but after the initiation of a lawsuit, where the communications concerned the pending lawsuit.

G. **Plans Not Subject to ERISA Fiduciary Rules**. A federal district court has held that the fiduciary exception does not apply to communications concerning a "top hat" plan, because such an arrangement is not subject to ERISA's fiduciary requirements (by reason of ERISA § 401(a)(1)). *Marsh v. Marsh Supermarkets, Inc.*, 2007 WL 1597938 (S.D. Ind. 2007). The court concluded that the fiduciary exception did not apply to negate the attorney-client privilege (or the work product doctrine) because that exception is premised on the existence of a fiduciary's duty to its beneficiaries, and no ERISA fiduciary duty is owed with respect to a top hat plan. The court did not address the possibility that a fiduciary duty could nevertheless be owed plan participants under non-ERISA law, and therefore did not address whether a non-ERISA fiduciary obligation would cause the fiduciary exception to apply.

A second federal district court has held that the fiduciary exception does not apply to communications concerning a "top-hat" plan, because such an arrangement is not subject to ERISA's fiduciary requirements. *Tolbert v. ARB Capital Markets Corp.*, 2012 U.S. Dist. LEXIS 42974, 53 EBC 2549 (S.D. Tex. 2012). The court also concluded, however, that disclosure to an actuary waived privilege with respect to that disclosure, though not as to other documents.

H. **Insurance Companies**. In a thoughtful exercise of independent thinking, the Third Circuit concluded that the fiduciary exception did not apply to communications between an insurance company and its attorneys, even though those communications related to the insurance company's actions as a fiduciary of a health plan subject to ERISA. *Wachtel v. Health Net, Inc.*, 482 F.3d 225, 40 EBC 1545 (3d Cir. 2007). Although the insurance company conceded that it was a fiduciary because of its discretion concerning claims decisions, it was not a plan administrator or trustee, and its fiduciary status arose only out of its discretionary authority over the payment of benefits owed to plan beneficiaries.

The *Wachtel* court reviewed the history and development of the fiduciary exception, and its application to ERISA fiduciaries by other courts. In tracing the introduction of the fiduciary exception into American law, the court focused on a Delaware Court of Chancery case, *Riggs National Bank of Washington, D.C. v. Zimmer*, 355 A.2d 709 (Del. Ch. 1976). In *Riggs*, a non-ERISA case, the court held that the beneficiaries of a trust were entitled to discover a legal memorandum which had been prepared for their trustees in connection with matters of trust administration, and for which the trustees had paid using trust assets. The court in *Wachtel* characterized the analysis in *Riggs* as follows:

> [T]he court found the memorandum to be discoverable for two reasons. First, the court placed a great deal of weight on the duty of a trustee to furnish information to the trust beneficiaries. Second, the court found the memorandum discoverable for the equally compelling reason that it determined that counsel's "real" clients – in whom, under longstanding principle – the attorney-client privilege vested – were the beneficiaries, not the trustees (whom the court described as mere representatives). Identification of the "real" client was informed by several factors: (1) the content of the advice was for the benefit of the trust, not the trustees; (2) the advice was paid for with assets of the trust, not the trustees; and (3) no adversarial proceedings against the trustees was pending, meaning that the trustees had no need to seek personal legal advice. Indeed, the court noted that a trustee who properly executes his duties acts *only* on behalf of the beneficiaries. In this case, the fiduciary exception is something of a misnomer because it is the beneficiary, rather than the trustee, who is the "client" component of the "attorney-client" privilege.

(Citations omitted). 482 F.3d at 231.

In discussing the personal liability exception and settlor exception (under the *Mett* and *In re Long Island Lighting* line of cases), the court in *Wachtel* stated:

> These two exceptions to the fiduciary exceptions (sic) share a common justification – both allow the attorney-client privilege to remain intact for an ERISA fiduciary when its interest diverge sufficiently from those of the beneficiaries that the justifications for the fiduciary exception no longer outweigh the policy underlying the attorney-client privilege. The beneficiaries are no longer the real clients, and disclosure of attorney-client communications is no longer an obligation.

482 F.3d at 234.

Drawing on the *Riggs* court's rationale for borrowing the 19th century English common law fiduciary exception, the court in *Wachtel* concluded that application of the exception required careful consideration of the particular circumstances, and that the fiduciary exception should not apply equally to all types of ERISA fiduciaries. The court concluded that the fiduciary exception did not apply to the subject communications between the insurance company and its attorneys because, in fact, the health plan participants were not the "real" clients obtaining legal representation. It reached this conclusion on the basis of (a) its consideration of four factors for determining who the "real" client is, and (b) an examination of any disclosure obligation the insurance company might have as to advice it receives.

As to the identity of the "real" client, the court stated that when a contractual service provider such as the insurance company being sued obtains legal advice regarding the execution of its fiduciary obligations, the beneficiaries of the benefit plans are not the "real" clients. 482 F.3d at 234. As noted earlier, the court looked to four factors in reaching this conclusion. The first was the ownership of the assets that would be used to pay claims. In the present case, which involved a claim for benefits, there was no trust (none was required under ERISA because the arrangement was insured), and the insurance company owned legal title to the assets that would be used to pay benefits.

Second, the insurance company had a structural (that is, inherent) conflict of interest because it was paying benefits from its own assets, which suggested that the participants would not have been the real clients to which the advice was directed. The court said as a fiduciary's level of conflict with plan participants increases, the participants' ability to claim they are the real clients diminishes.

The third factor examined in determining whether the insurance company, or instead the participants, were the real client, was the conflict that resulted from the insurance company administering claims for multiple ERISA benefit plans, as well as non-ERISA customers. That conflict was the insurance company's need to satisfy its duties not only to participants in the plan at issue, but also to beneficiaries of other plans (as well as non-plan customers), all of whom were to be paid from the same pool of assets.

The fourth factor concerned the source of payment for legal advice. The court stated that "[c]ourts have noted that when a trustee pays counsel out of trust funds, rather than out of its own pocket, the payment scheme is strongly indicative of the beneficiaries' status as the true clients." 482 F.3d at 235-36. The court continued "[c]onversely, when a fiduciary obtains legal advice using its own funds, the payment scheme is an indicator (albeit only an indicator) that the fiduciary is the client, not a represent." 482 F.3d at 236.

As to the "real" client, the court summed up as follows:

> Together, these four factors – unity of ownership and management, conflicting interests regarding profits, conflicting fiduciary obligations, and payment of counsel with the fiduciary's own funds – indicate that an insurer which sells insurance contracts to ERISA-regulated benefit plans is itself the sole and direct client of counsel retained by the insurer, not the mere representative of client-beneficiaries, and not a joint client with its beneficiaries. Were the insurer's counsel to also represent the beneficiaries who seek to maximize their benefit payments, that counsel would face a direct conflict of interest under any standard of legal ethics. It would be odd indeed if ERISA were to force lawyers into precisely this conflicted role.

482 F.3d at 236.

The court looked not only at the identity of the "real" client for whom the advice was intended, but also the second possible rationale for applying the fiduciary exception – the fiduciary's duty of disclosure. The court, in concluding that there was no duty of the insurance company to disclose to plan participants the advice it received from counsel, explained as follows:

> The obligation of a trustee to disclose to beneficiaries the advice of counsel retained by the trust has been recognized in each of three Restatements of Trusts. Some courts have used language broad enough to suggest that *every* ERISA fiduciary has an obligation to disclose counsel's statements to its beneficiaries.
>
> We conclude that such broad language does not represent an intentional expansion of the fiduciary exception. Because fiduciary duties under ERISA "draw much of their content from the common law of trusts," it is appropriate to apply a trustee's disclosure obligations to ERISA plan administrators who operate as trustees. When Congress extended obligations under the common law of trusts to reach entities which had not been deemed to be trustees under the common law, however, Congress did not intend to expand the full panoply of trustees' obligations to every entity which might designated a fiduciary under ERISA. Specifically, Congress provided that the assets of an insurance company need not be held in trust. For that reason, we do not believe that Congress intended to impose upon insurance companies doing business with ERISA-regulated plans the same disclosure obligations that have been imposed upon trustees at common law. [29 U.S.C.] Section 1103(b)(1)-(2) excepts insurers from trustee-like obligations; we see no reason to impose trustee-like disclosure obligations upon an entity excepted from ERISA's analogy to trust. Thus, simply because an insurer has certain limited fiduciary obligations under ERISA, those obligations are not coextensive with the common law obligations of a trustee.

(citations omitted) 482 F.3d at 236.

The Ninth Circuit has rejected the *Wachtel* holding, concluding that there is "no principled basis for excluding insurers from the fiduciary exception." *Stephan v. UNUM Life Ins. Co. of Am.*, 697 F.3d 917 (9th Cir. 2012). In rejecting the insurer's argument that documents were nevertheless privileged under the personal liability exception (to the fiduciary exception, noted in Section IV.F above), the court said the documents at issue were notes of conversations between the insurer's claim analysts and the insurer's in-house counsel about how an insurance policy ought to be interpreted and whether, under a disability policy, an employee's bonus ought to be considered monthly earnings within the meaning of the plan. Unlike the memoranda at issue in *Mett*, the disputed documents offered advice only with respect to how the plan ought to be interpreted, and did not address any potential civil or criminal liability the insurer might face, nor was there any indication that the documents were prepared with that type of liability in mind.

A federal district court outside the Third Circuit has rejected the *Wachtel* holding, finding the rationale in *Wachtel* unpersuasive given the status of the law in the First Circuit (in which the court sits). *Smith v. Jefferson Pilot Financial Ins. Co.*, 245 F.R.D. 45 (D. Mass. 2007). The court held that the fiduciary exception applied to communications between an insurance company's claims personnel and in-house legal counsel, where the advice related to the insurance company's role as fiduciary in adjudicating claims.

A federal district court in the Fourth Circuit cited *Wachtel*, as well as *Tatum* (discussed above in the section captioned "Personal Liability"), in holding that an insurance company deciding claims and paying long-term disability benefits from its own assets enjoyed privilege with respect to communications occurring after a plan participant's claim was denied and after the participant threatened the insurance company with litigation. *Fortier v. Principal Life Ins. Co.,* 2008 U.S. Dist. LEXIS 43108 (E.D. N.C. 2008).

A federal district court in the Eighth Circuit has expressly rejected *Wachtel*. *Buzzanga v. Life Ins. Co. of N. Am.*, 2010 U.S. Dist. LEXIS 33089, 49 EBC 1032 (E.D. Mo. 2010). The case involved a claim for accidental death benefits under a group accident policy issued by an insurance company to an employer. Four documents were the subject of a privilege dispute. These consisted of a request to in-house counsel for a legal opinion and three research memoranda regarding applicable law governing DUI claims in an accidental death insurance context. Three of the disputed communications occurred before the insurer denied the plaintiff's initial claim. The fourth occurred after that initial denial, and a few days before the insurer denied the plaintiff's appeal of the initial denial.

Noting the standard pre-decisional/post-decisional line of demarcation for determining which documents enjoy attorney-client privilege, and expressly rejecting the holding in *Wachtel*, the court ruled that there was no attorney-client privilege nor work product privilege with respect to the three documents generated before the initial claim was denied. As to the work product privilege, the court said "the divergence of the beneficiary's interests from those of the plan administrator had not yet occurred." In so holding, the court quoted from *Geissal v. Moore Med. Corp.*, *supra* in Part IV.F, as follows:

> While litigation can result from any fiduciary act, the administrator's acts of securing legal advice for the plan . . . prior to the plan's decision regarding benefits cannot be said to be in anticipation of litigation.

As to the fourth document, which was generated after the plaintiff appealed the initial denial, but six days before the denial was upheld by the insurer on appeal, the court found that the insurer enjoyed work product privilege. By that time, "the prospect of litigation was sufficient to erect the attorney work product doctrine as a bar to the subject information." (Quoting from *Geissal*.)

I. **<u>A Chink in the Fiduciary Exception</u>**? The Supreme Court, in *U.S. v. Jicarilla Apache Nation*, 131 S. Ct. 2313 (U.S. 2011), held, in a non-ERISA case, that the United States, as trustee of tribal property, was not subject to the fiduciary exception under trust law. The court made note of the ERISA distinction in discussing the fiduciary exception, but offered little comment expressly of approving or disapproving those decisions. Possibly of note, the court gave considerable weight to the source of the funds used to pay legal counsel, noting that the government's attorneys were paid from Congressional appropriates with no cost to the tribe, and observing that the significant factor in determining who is the "real client" who should have access to advice. The court put it this way:

> Here, the Government attorneys are paid out of congressional appropriations at no cost to the Tribe. Courts looked to the source of funds as a "strong indicator of precisely who the real clients were" and a "significant factor" in determining who ought to have access to the legal advice. We similarly find it significant that the attorneys were paid by the Government for advice regarding the Government's statutory obligations.
>
> The payment structure confirms our view that the Government seeks legal advice in its sovereign capacity rather than as a conventional fiduciary of the Tribe.

In a post-*Jicarilla* case, a federal district court found that an insurer had no privilege even after it denied a benefit appeal, because it voluntarily reconsidered its decision. Although the decision came after *Jicarilla*, it did nothing more than mention the Supreme Court's decision. *Moore v. Metropolitan Life Ins. Co.*, 799 F.Supp.2d 1290 (M.D. Ala. 2011).

In another post-*Jicarilla* decision, another federal district court concluded that *Jicarilla* "arguably supports the application of the fiduciary exception in the ERISA context, . . . and certainly does not alter or overrule the line of cases that have applied the fiduciary exception to ERISA fiduciaries . . . ." As with *Moore*, above, there was no privilege for documents created for administrative purposes during the administrator review process <u>as extended by the insurer</u>. Also, there was no work product protection because the court applied a fiduciary exception even to that privilege, and because the documents were prepared as part of claims administration – that is, for business purposes – as opposed to in response to, or in anticipation of, litigation. The court seemed to think this followed from the fact that the insurer had not finally determined the claimant's claim.

In yet a further post-*Jicarilla* decision, a federal district court concluded that *Jicarilla* "arguably supports application of a fiduciary exception in ERISA contexts, . . . and certainly does not alter or overrule the line of cases that have applied the fiduciary exception to ERISA fiduciaries . . . ." *Harvey v. Standard Ins. Co.*, 2011 U.S. Dist. LEXIS 107834, 53 EBC 2185 (N.D. Ala. 2011). As with *Moore*, there was no privilege for documents created for administrative purposes during an administrative review process, as extended by the insurer. Also, there was no work product protection because the court applied a fiduciary exception even to that privilege, and because the documents at issue were prepared as part of the claims administration process – that is, for business purposes – as opposed to in response to, or in anticipation of, litigation. The court seemed to think this followed from the fact that the insurer had not finally determined the claimant's claim.

J. **Waiver**. Clients and their attorneys must guard against waiver of privilege by the disclosure of otherwise confidential communications. In *Lewis v. Unum Corp. Severance Plan*, 203 F.R.D. 615 (D. Kan. 2001), an employer waived privilege with respect to communications between in-house counsel and a human resources representative by sending otherwise privileged documents to the plan administrator, a nonprivileged third party fiduciary.

1. **Disclosure to Consultants**. In a dispute concerning the disclosure of minutes of fiduciary committee meetings, a federal district court concluded that the presence of the employee benefits consultant firm Wyatt Watson at meetings would destroy any attorney client privilege that might otherwise exist, because the firm's presence was not necessary to assist the attorney in the provision of legal advice (that is, the loss of privilege due to waiver was not prevented under the *Kovel* doctrine, described in Section IV.A above), and because there was no explanation of why Wyatt Watson would "need to know" the information disclosed, so there was no ability to avoid the waiver where an outside consultant functions like an employee, as described in *Graf* (discussed in Section IV.B above). *Hill v. State Street Corp.*, 2013 U.S. Dist. LEXIS 181168, 57 EBC 2036 (D. Mass. 2013).

In an interesting decision, a federal district court concluded that the presence of two consultants at a multiemployer pension plan board of trustees meeting would not prevent attorney-client privilege (nor work product privilege) from attaching to legal advice provided by counsel to the fund. *Trustees of the Electrical Workers Local No. 26 Pension Trust Fund v. Trust Fund Advisors, Inc.*, 2010 U.S. Dist. LEXIS 12578, 48 EBC 2138 (D. D.C. 2010). In determining whether privilege attached, the court concluded that it was irrelevant whether the non-trustees present at the meeting were employees of the fund (or plan) or instead consultants. The proper question, the court said, was whether the presence of the two consultants while the trustees and fund counsel were having ostensibly privileged communications, and the consultants' subsequent review of minutes that memorialized those discussions, was "consistent with the purpose and traditional interpretation of the common law attorney-client privilege."

One of the consultants was an unpaid, nonvoting advisor who appeared to serve a substantial and integral role in the operation of the plan. The consultant, who was the Executive Director of the National Electrical Contractors Association, had been authorized by the trustees to attend trustees' meetings and to provide advice. The consultant had responsibility for collections (he was a member of a two-person collection committee), and was expected to advise the trustees on the performance of their fiduciary responsibilities, to communicate with counsel concerning counsel's legal advice, and to monitor the conduct of the fund administrator, trustees, professional consultants, contributing employers, and participants, to make sure that conduct was consistent with the relevant collective bargaining agreement, the plan documents, and the appropriate regulatory laws. Plan representatives asserted that the consultant's role was one that would have been performed by a paid employee if the plan had any paid employees.

The second individual was an investment consultant who helped the trustees with their decisions to hire and fire investment managers. (The underlying lawsuit was against an investment manager that had been terminated.) Counsel to the plan communicated with the investment consultant regularly, both at and outside board meetings, concerning legal issues relating to the plan's investments and investment managers. The attorney considered the investment consultant to be a fiduciary (under ERISA Section 3(21)).

The court held that the presence of the consultants at the board meetings, and their review of subsequent minutes memorializing discussions at those meetings, did not prevent privilege from attaching to the advice provided by counsel. The court concluded that both consultants seemed to have had "significant managerial responsibilities that would have been done by high-level corporate managers, had the Plan been incorporated." Further, there was no reason to think the trustees would have thought the consultants' "presence at meetings where matters that fell within their expertise and experience were being discussed would defeat the privilege that would otherwise attend the Board's discussions with counsel." Moreover, the court said the trustees relied on the consultants for "important work that often required legal guidance," and that extending privilege in this context would advance the purpose of attorney-client privilege (encouraging a frank discussion) without creating "any potential for its misuse."

2. **Disclosure to Actuary**. In *Cottillion v. United Refining Co.*, 2011 U.S. Dist. LEXIS 151519, 53 EBC 1275 (W.D. Pa. 2011), a federal district court considered a dispute concerning an actuarial reduction in early retirement benefits. As to the inapplicability of the fiduciary exception for advice concerning personal liability (see the *U.S. v. Mett* discussion in Section IV.F), the court held that the interest of the plan beneficiaries diverged from the plan trustee's interest when the trustee took concrete steps to actuarially reduce benefits to retirees already in pay status and to recoup overpayments, because at that point a serious and significant threat of litigation had materialized. An attorney's action in copying an actuary on an email did not waive attorney-client privilege because the actuary's involvement was at the direction of the attorney, to assist the attorney in the provision of legal advice. As to whether a disclosure to the actuary constitutes a waiver, the court said the critical inquiry is "whether the third party consultant is involved in the giving of legal advice" or "functions like an employee in providing information which facilitates the obtaining of legal advice." The key in the instant case was that the communications with the actuary were at the attorney's direction, for the express purpose of assisting him in providing legal advice.

An email from the actuary to a committee member regarding recouping payments was not, however, privileged, even if it was at the attorney's direction because it concerned only accounting issues related to the administration of the plan (and was prepared for non-litigation purposes, not in anticipation of litigation).

The court also concluded as follows:

1. An attorney's draft document subject to revision was not automatically privileged.

2. A proposed response to an inquiry from a beneficiary relating to a reduction in benefits enjoyed no privilege because it was related only to plan administration.

3. A draft form of a letter to participants regarding a benefit reduction in a VCP process was related to administration of the plan, and therefore not privileged.

4. Discussions of plan amendments concerned settlor issues, so the fiduciary exception was inapplicable.

5. Meeting minutes generally were not privileged, except small portions containing legal advice falling within the personal liability limitations of the fiduciary exception.

The court also concluded that letters to auditors relating to the annual plan audit were not privileged.

For another case in which a federal district court concluded that disclosure to an actuary waived privilege with respect to that disclosure (but not as to other documents), *see Tolbert v. ARB Capital Markets Corp.*, 2012 U.S. Dist. LEXIS 42974, 53 EBC 2549 (S.D. Tex. 2012). The court also concluded that because top-hat plans are exempt from ERISA's fiduciary duties, the fiduciary exception to the attorney-client privilege does not apply.

3. **Disclosure in Response to Request of Government Agency or Inadvertent Disclosure in Civil Discovery**. Note that a state appellate court concluded that the disclosure of information to certain federal agencies did not waive attorney-client and attorney work product privileges as to the disclosed documents in *Regents of University of California v. Superior Court*, 2008 WL 2908123 (Cal. App. 2008). In summarizing the relevant California authority on waiver, the court indicated that when privileged documents have been disclosed either in response to the request of a government agency or inadvertently in the course of civil discovery, no waiver of privilege will occur if the holder of the privilege has taken reasonable steps under the circumstances to prevent disclosure. The law, the court said, does not require that the holder of the privilege take "strenuous or Herculean efforts" to resist disclosure. In the instant case, which did not involve an employee benefit plan or ERISA, the court found that privilege was not lost since the defendants produced privileged documents to the federal Department of Justice in an antitrust case only because they believed there would be severe regulatory or criminal consequences if they were labeled by the government as uncooperative, and not by reason of any voluntary, noncoerced disclosure.

4. **Representing Executives: Risk in Using Employer-Owned Computer**. There is a developing body of law, perhaps not entirely consistent or coherent, concerning the waiver of attorney-client privilege, and potentially work product privilege, where an executive or other employee makes use of an employer-owned computer to correspond with an attorney by e-mail. For a general discussion, see *Clicking Away Confidentiality: Workplace Waiver of Attorney-Client Privilege* by Adam C. Losey, 60 Fla. L. Rev. 1179 (2008). It appears that using an employer-owned computer to access an executive's (or other employee's) personal e-mail account may waive privilege as to the contents of those e-mails. That may be true even where the executive's e-mail account is password-protected. Although the law is evolving, it appears that where an employer provides explicit warning to employees that they should have no expectation of privacy while using an employer-owned computer, there may be no attorney-client privilege as to e-mails sent or accessed from such a computer, even where those e-mails are sent or accessed through use of a personal password-protected e-mail account. See, generally, *Long v. Marubeni America Corp.*, 2006 U.S. Dist. LEXIS 76594 (S.D. N.Y. 2006); *Nat'l Economic Research Assocs., Inc. v. Evans*, 2006 Mass. Super.

LEXIS 371, 21 Mass. L. Rep. 337 (Mass. Super. Ct. 2006); *Curto v. Medical World Communications, Inc.*, 2006 U.S. Dist. LEXIS 29387 (E.D. N.Y. 2006).

5. **<u>Bank of America Settlement with SEC Over Merrill Lynch Transaction</u>.** A federal district court has raised a question about the waiver of attorney-client privilege where parties raise an "advice of counsel" defense in an SEC enforcement action. *SEC v. Bank of America Corp.*, 1:09-CV-06829 (S.D. N.Y. Aug. 25, 2009). The court has at least initially refused to approve a settlement of SEC disclosure violation allegations, under which the company, Bank of America, would pay a $33 million fine, in part because the court wanted more information from the parties on whether Bank of America had waived attorney-client privilege. If it had not waived privilege, the court wanted a fuller explanation of how the SEC, in deciding not to bring charges against individual responsible officers of Bank of America, could credit those individual officers' statements that they relied on counsel concerning preparation of the allegedly misleading disclosure. The point that seemed to trouble the court most was that the burden of the proposed $33 million penalty would fall to shareholders, and "arguably indirectly on U.S. taxpayers," instead of on individual officers associated with the misleading proxy statement.

The SEC had characterized its complaint as involving a straightforward disclosure violation, which it described as follows:

> In the joint proxy statement, Bank of America represented that Merrill [Lynch] had agreed not to pay year-end performance bonuses or other discretionary incentive compensation to its executives prior to the closing of the merger without Bank of America's consent. In fact, Bank of America already had agreed that Merrill *could* pay a material amount of discretionary year-end and other bonuses to Merrill executives for 2008. Although the merger agreement was included as an exhibit and discussed in detail in the joint proxy statement, Bank of America's agreement allowing Merrill to pay discretionary bonuses was memorialized in a separate "disclosure" schedule that was omitted from the proxy statement and the contents of which were not disclosed prior to the shareholder vote on December 5, 2008.

The amount of the discretionary year-end bonuses was $5.8 billion. The SEC argued that the $5.8 billion in bonuses that Bank of America authorized Merrill to pay constituted nearly 12 percent of the $50 billion purchase price, and was nearly 30 percent of Merrill's total shareholder stockholder equity.

Bank of America officers told the SEC they relied entirely on legal counsel in deciding what was to be disclosed in the proxy statement. The court explained its concern with the SEC's process in deciding not to charge individual officers as follows:

> If the responsible officers of the Bank of America, in sworn testimony to the SEC, all stated that "they relied entirely on counsel," this would seem to be either a flat waiver of privilege or, if privilege is maintained, then entitled to no weight whatever, since the statement cannot be tested.
>
> * * * * *
>
> If the SEC is right in [asserting that no waiver occurred], it would seem that all a corporate officer who has produced a false proxy statement need offer by way of defense is that he or she relied on counsel, and, if the company does not waive the privilege, the assertion will never be tested, and the culpability of both the corporate officer and the company counsel will remain beyond scrutiny.

The court ordered the parties to further brief the privilege issue. In those further briefs, the SEC explained its analysis as follows:

> [C]orporate penalties are indirectly borne by shareholders. Accordingly, where shareholders have been harmed by violations the Commission will "seek penalties from culpable individual offenders acting for a corporation." [*Statement of the Securities and Exchange Commission Concerning Financial Penalties*, SEC Rel. No. 2006-4 (Jan. 4, 2006).] In the view of the Commission, however, the investigative record here does not provide an appropriate factual basis to charge individuals. The uncontroverted evidence in the investigative record is that lawyers for Bank of America and Merrill drafted the documents at issue and made the relevant decisions concerning disclosure of the bonuses. During the course of the investigation, key executives all stated that they delegated these decisions to counsel, who were aware of the relevant business terms of the transaction. There is no evidence that company executives separately discussed concealing compensation information and the executives questioned stated that there were no such discussions. Although the Commission assigns no weight to assertions of reliance on counsel in assessing the state of mind of the executives, under these uncontroverted facts and circumstances – that it was the lawyers rather than the

> executives themselves who made the actual disclosure decisions – there is a lack of evidentiary support to establish the factual predicate that is necessary to allege scienter-based fraud charges against company executives. Similarly, there is an insufficient evidentiary basis to establish a *prima facie* case of the requisite scienter with respect to the lawyers for purposes of alleging secondary liability under the securities laws.

As to privilege, the SEC stated that the Bank of America repeatedly asserted attorney-client privilege with respect to the production of documents in regard to testimony or interviews of witnesses, and had consistently declined to waive the privilege. The Commission indicated that its staff, as a matter of policy, will not credit an advice of counsel defense if a party in an investigation refuses to waive the privilege.

The SEC indicated that under Second Circuit precedent, the assertion by a party in an <u>investigative</u> setting that they have relied on counsel, or that they may have a defense based on such reliance, generally does not constitute a waiver of the attorney-client privilege (citing *John Doe Co. v. U.S.*, 350 F.3d 299 (2d Cir. 2003)). The result may be different, and there may be an implied waiver, where an advice of counsel defense is raised in a <u>judicial</u> setting. See *In re Grand Jury Proceedings*, 219 F.3d 175, 183 (2d Cir. 2000); *Sanofi-Synthelabo v. Apotex Inc.*, 363 F. Supp. 2d 592, 595 (S.D. N.Y. 2005); *In re Keeper of Records*, 348 F.3d 16, 23 (1st Cir. 2003); *U.S. v. White*, 887 F.2d 267, 270-71 (D.C. Cir. 1989).

There was, incidentally, expert testimony offered on behalf of Bank of America that it is typical to restrict “competitively sensitive” information, such as bonus information, to a separate disclosure schedule that is not included with the proxy statement. Bank of America also argued that the “total mix” of information available to shareholders, including media reports about the likelihood Merrill would pay billions of dollars in bonuses that preceded the shareholder vote in the merger, and SEC filings indicating that Merrill planned 2008 employee compensation roughly equal to what it had paid in 2007, effectively disclosed the incentive compensation.

The court ultimately approved a revised settlement, in an order dated February 22, 2010, though it did so with considerable reluctance. The settlement included some corporate governance measures designed to prevent nondisclosures in the future and a fine of $150 million. As with the previously rejected settlement, the $150 million fine – which the court characterized as “very modest” and appearing to be “paltry” – would be assessed against the company, and not against any individuals at the company. As to the court’s previously expressed concern about there being no penalty against individuals, the court seemed to abide this result by accepting as a reasonable conclusion (though not necessarily the one the court would have reached of its own accord) the SEC's view that the Bank and its officers acted only negligently, rather than intentionally, in causing nondisclosures concerning Merrill bonuses and Merrill's deteriorating financial performance.

The approved settlement would distribute the $150 million only to former Bank of America shareholders, who were the shareholders harmed by the Bank's nondisclosures, and not to former Merrill shareholders who now own Bank of America stock, nor to Bank officers or directors who had access to the undisclosed information. The court observed that the effect of targeting the allocation of the settlement proceeds in this way (rather than allocating the proceeds to all shareholders) would be modest, "amounting perhaps to no more than a few pennies per share," and noted that although the legacy Merrill shareholders may have received a bit of a windfall as a result of the nondisclosures, they had in fact not been responsible for those nondisclosures yet would not be sharing in the settlement proceeds.

In one of the most interesting developments leading up to the settlement, Bank of America, which had been under considerable pressure to waive attorney-client privilege, did so to a limited extent under the terms of a protective order issued by the court on October 14, 2009. The court characterized the order as allowing Bank of America to waive attorney-client privilege and work-product protection regarding certain categories of information material to the case (and which would seemingly be relevant as well to certain ongoing state and federal inquiries, including a host of pending civil lawsuits) without waiving that privilege and protection regarding other information that might be of interest in related private lawsuits. The court stated that this protective order comported with new Rule 502 of the Federal Rules of Evidence, as amended in 2008, which the court indicated permits such "cabined" waivers. The court's protective order listed 58 pending civil actions and stated that although Bank of America intended to waive attorney-client privilege and work-product protection with respect to certain enumerated matters, it was not waiving privilege with respect to information relating solely to the legal defense of those private lawsuits.

At least one commentator has questioned whether the protective order will have the effect desired by Bank of America. See "Did Bank of America Mess Up Its Privilege Waiver?," by Zach Lowe, Law.com, October 20, 2009. One of the commentator's criticisms of the order concerns its use of the term "waiver." The commentator argued that Rule 502 does not deal with "waivers," but instead with the ability to disclose privileged documents in a limited way under the terms of a court order, and not a waiver. Whether or not this is an overly technical reading of Rule 502, the commentator also questioned whether, under the terms of the order, documents disclosed to the SEC are protected from discovery by other parties in other litigation. This latter issue may be tested in the relatively near future given that in what is apparently the largest of the civil lawsuits, involving the consolidation of 30 cases relating to the Bank of America/Merrill Lynch merger, the court lifted the automatic stay under the Private Securities Litigation Reform Act (the "PSLRA") to permit discovery, prior to the court ruling on any motion to dismiss, of documents produced by Bank of America to government agencies (including the SEC, Congress, the New York Attorney General, and the North Carolina Attorney General), as well as transcripts of testimony given in connection with those investigations. *In re Bank of America Corp. Securities, Derivative, and ERISA Litigation*, 2009 U.S. Dist. LEXIS 108322 (S.D.N.Y. 2009). And another derivative case against the Bank of America and pending in the Delaware Chancery Court has reportedly survived a motion to dismiss, so discovery can begin even without a waiver of the automatic stay under the PSLRA.

6. **Federal Rule of Evidence 502: Subject Matter Waiver and Inadvertent Disclosures in Federal Proceedings or to a Federal Agency**. In late 2008, President Bush signed into law a bill adding new Federal Rule of Evidence 502. Pub. L. 110-322.

Federal Rule of Evidence 502 reads, in its entirety, as follows:

> **(a) DISCLOSURE MADE IN A FEDERAL PROCEEDING OR TO A FEDERAL OFFICE OR AGENCY; SCOPE OF A WAIVER.—**When the disclosure is made in a Federal proceeding or to a Federal office or agency and waives the attorney-client privilege or work-product protection, the waiver extends to an undisclosed communication or information in a Federal or State proceeding only if:
>
> (1) the waiver is intentional;
> (2) the disclosed and undisclosed communications or information concern the same subject matter; and
> (3) they ought in fairness to be considered together.
>
> **(b) INADVERTENT DISCLOSURE**. – When made in a Federal proceeding or to a Federal office or agency, the disclosure does not operate as a waiver in a Federal or State proceeding if:
>
> (1) the disclosure is inadvertent;
> (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and
> (3) the holder promptly took reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26(b)(5)(B).

(c) DISCLOSURE MADE IN A STATE PROCEEDING.— When the disclosure is made in a State proceeding and is not the subject of a State-court order concerning waiver, the disclosure does not operate as a waiver in a Federal proceeding if the disclosure:

(1) would not be a waiver under this rule if it had been made in a Federal proceeding; or

(2) is not a waiver under the law of the State where the disclosure occurred.

(d) CONTROLLING EFFECT OF A COURT ORDER.— A Federal court may order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court – in which event the disclosure is also not a waiver in any other Federal or State proceeding.

(e) CONTROLLING EFFECT OF A PARTY AGREEMENT. **–** An agreement on the effect of disclosure in a Federal proceeding is binding only on the parties to the agreement, unless it is incorporated into a court order.

(f) CONTROLLING EFFECT OF THIS RULE. **–** Notwithstanding Rules 101 and 1101, this rule applies to State proceedings and to Federal court-annexed and Federal court-mandated arbitration proceedings, in the circumstances set out in the rule. And notwithstanding Rule 501, this rule applies even if State law provides the rule of decision.

(g) DEFINITIONS. **–** In this rule:

(1) "attorney-client privilege" means the protection that applicable law provides for confidential attorney-client communications; and

(2) "work-product protection" means the protection that applicable law provides for tangible material (or its intangible equivalent) prepared in anticipation of litigation or for trial.

The Federal Rules of Evidence apply in the federal district courts, and also in the Tax Court pursuant to Tax Code Section 7453 and Tax Court Rule 143(a). The new rule addresses the waiver of attorney-client privilege and work-product protection when disclosures are made "in a Federal proceeding" or to a "Federal office or agency." The rule addresses both (a) whether a disclosure in those contexts constitutes a waiver of the attorney-client privilege or work-product protection with respect to undisclosed communications or information concerning the same subject matter (a "subject matter waiver"), and (b) whether an inadvertent disclosure operates as a waiver at all.

The stated objective for adoption of the rule was to alleviate the costs associated with electronic discovery in document production in litigation, by reducing the risks associated with inadvertent production of protected material. Under the rule, where an attorney inadvertently discloses information, the disclosure will not constitute a waiver so long as (a) the holder of the privilege or protection took reasonable steps to prevent disclosure, and (b) the holder promptly took reasonable steps to rectify the error, which might include utilizing the procedure in Federal Rule of Civil Procedure 26(b)(5)(B) for attempting to "clawback" the inadvertently disclosed information. FRE § 502(b).

As to an intentional disclosure made during a Federal proceeding or to a Federal office or agency, Rule 502(a) addresses the issue of subject matter waiver. Generally, a waiver resulting from such a voluntary disclosure will only extend to an undisclosed communication or information in a Federal or State proceeding if (1) the waiver was intentional, (2) the disclosed and undisclosed communications or information concern the same subject matter, and (3) the disclosed and undisclosed communications or information "ought in fairness" be considered together.

The first of these requirements – that the disclosure have been intentional – is a repudiation of the position previously taken by some courts that inadvertent disclosure of protected material can constitute a general subject matter waiver as to other documents or information. The third requirement – that the disclosed and undisclosed communications "ought in fairness" be considered together – is presumably intended to prevent parties from engaging in the intentional and misleading use of protected or privileged information. As the IRS' Office of Chief Counsel put it in Chief Counsel Notice 2009-023, "[i]f a party intentionally places protected information into the litigation in a selective, misleading and unfair manner, then there will be a waiver as to the undisclosed information concerning the same subject matter." That, presumably, is because the intentionally disclosed information and the undisclosed information ought in fairness be considered together, to prevent the disclosing party from misleading others.

The referenced Chief Counsel Notice, which is attached to this outline as **Appendix A**, summarizes nicely both the background and effect of Rule 502. Rule 502(e) expressly authorizes parties to enter into an agreement on the effect of disclosure in a Federal proceeding, though that agreement will be binding only on the parties to it unless it is incorporated into a court order. The Chief Counsel Notice, though, cautions those at the Service to avoid claw-back agreements (agreements regarding the disposition of inadvertently produced documents) and quick-peek agreements (agreements allowing the requesting party to take a quick peek at documents without the producing party undertaking the time and expense in advance to review the entire population of documents). The Service's concern with these types of agreements is, in part, that entering into them without first establishing that the documents are privileged or protected may give taxpayers the impression that they are entitled to these agreements, and that the government must negotiate an appropriate agreement before a taxpayer must turn over responsive documents.

As to quick-peek agreements, the Chief Counsel Notice termed them "inconsistent with the producing party's duty to take reasonable steps to prevent disclosure of privileged or protected information." The Office of the Chief Counsel also expressed concern about the effect of such agreements on other parties. The Chief Counsel Notice put it this way:

> Entering into a non-waiver agreement with a view to adoption by the court might be viewed as the Service taking a partisan position in pending or prospective litigation between private litigants for expediency's sake. For example, it may be argued that the entry of a Rule 502(d) order raises a question of whether that order violates the Due Process rights of persons and entities who are not parties to the Tax Court litigation because the rule purports to make an order of the court binding on all persons and entities in all federal or state proceedings, whether or not they were the parties to the litigation and regardless of whether the nonparties are subject to the jurisdiction of the Tax Court.

V. <u>**Work Product Doctrine**</u>.

Even when no attorney-client privilege applies, certain attorney-client communications may be protected from discovery under the work product doctrine. That doctrine was established by the U. S. Supreme Court in *Hickman v. Taylor*, 329 U.S. 495 (1947), and is codified as Rule 26(b)(3) of the Federal Rules of Civil Procedure as follows :

> [A] party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

Attorney-client privilege belongs to the client and the client alone. In contrast, the work product rule may be claimed by either a client or an attorney. *E.g., Donovan v. Fitzsimmons*, 90 F.R.D. 583, 587, 2 EBC 1393 (N.D. Ill. 1981); *Everett v. USAir Group, Inc.*, 165 F.R.D. 1 (D.D.C. 1995). Disclosure to third parties does not normally work a waiver of work product protection, unless that disclosure involves a significant likelihood that a litigation adversary will obtain the materials. *Castle v. Sangamo Westin, Inc.*, 744 F.2d 1464 (11th Cir. 1984); Restatement § 91(4).

The work product doctrine may not be applied against a client (or against a client's interest). In *Everett v. USAir Group, Inc.*, 165 F.R.D. 1 (D.D.C. 1995), the court concluded that although "the [work product] privilege belongs, at least in part, to the attorney," attorneys generally "may not invoke it to shield their attorney-work product from their own ultimate clients, the plan beneficiaries." As a consequence, even where documents were prepared expressly in anticipation of litigation, they were not protected "in so far as they were prepared in anticipation of litigation on behalf of the plan beneficiaries." 165 F.R.D. at 5.

A. <u>In "Anticipation of Litigation</u>." Importantly, the work product privilege applies only where material is prepared in "anticipation of litigation." Restatement § 87, cmt. i. If material is not prepared in anticipation of litigation, a party seeking discovery need not show a "substantial need" or "undue hardship" to overcome a claim of work product privilege. For employee benefits cases addressing application of the work product privilege *see Helt v. Metropolitan District Commission*, 113 F.R.D. 7, 7 EBC 2617 (D. Conn. 1986) (correspondence between trustees and pension plan attorneys did not enjoy work product privilege where the correspondence was made prior to the date the trustees received "demand or warning of charges or information from an outside source that a claim, demand, or charge was in prospect") (quoting *United States v. American Telephone & Telegraph*, 86 F.R.D. 603, 627 (D.D.C. 1979)); *Wsol v. Fiduciary Management Associates, Inc.*, 1999 WL 1129100, 23 EBC 2583 (N. D. Ill. 1999) (letter and report prepared by attorney enjoyed work product privilege where attorney was retained following the publication of articles in the press, receipt of correspondence, and issuance of federal subpoenas from a grand jury, all suggesting irregular and improper practices connected with the fund's investments, since litigation arising from these practices could be anticipated); *Hudson v. General Dynamics Corp.*, 186 F.R.D. 271 (D. Conn. 1999) (quoting the Second Circuit's decision in *United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995), *order vacated by*, 134 F.3d 1194 (2d Cir. 1998) for the proposition that "there is no rule that bars the application of work product rule to documents created prior to the event giving rise to litigation"); *Beal v. Treasure Chest Casino*, 1999 WL 461970 (E.D. La. 1999) (no work product protection for (a) a third-party administrator's "report to file" memorializing steps taken during investigation of a participant's claim, (b) a letter from the third-party administrator requesting a legal opinion on the claim, or (c) a written report to an underwriter 12 days after the plaintiff notified the employer he had retained an attorney, because each of these was considered to have been prepared in the ordinary course of insurance business); *Martin v. Valley National Bank*, 140 F.R.D. 291 (S.D. N.Y. 1991), *summary judgment granted sub nom Reich v. Valley National Bank*, 837 F. Supp. 1259, 17 EBC 1257 (S.D. N.Y. 1993) (Department of Labor enjoyed no work product protection for certain forms and internal memoranda since, although litigation was sufficiently foreseeable with respect to some of the documents, DOL failed to prove the documents were prepared principally to assist in litigation; work product protection did not apply to a document prepared before a formal investigation was opened, since there could be no work product protection until the Department of Labor demonstrated the discovery of information that made litigation likely); *United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995), *order vacated by*, 134 F.3d 1194 (2d Cir. 1998) (in tax litigation, documents can be prepared in anticipation of litigation even before the subject transaction had been investigated and, in fact, even before the transaction occurs; whether work product rule applies depends on how firm the expectancy of litigation is); *Schmidt, Long & Associates, Inc. v. Aetna U.S. Healthcare, Inc.*, 2001 U.S. Dist. LEXIS 7145, 26 EBC 1828 (E.D. Pa.), *summary judgment granted in part, denied in part*, 2001 U.S. Dist. LEXIS 10709 (E.D. Pa. 2001) (no work product protection applied to documents prepared by an independent auditor hired to review claims administration, because the likelihood of litigation depended on the results of that audit).; *Anderson v. Sotheby's Inc. Severance Plan*, ___________ (S.D.N.Y. May 13, 2005) (Case No. 04 CIV 8180 (SAS)(DFE)) (documents created in the ordinary course of assessing a participant's claim for severance benefits are not protected under the work product doctrine).

B. **Fiduciary Exception?** Several courts have concluded that there is no fiduciary exception to the work product doctrine (analogous to the fiduciary exception to attorney-client privilege). These courts have refused to create a fiduciary exception to the work product doctrine, in part, because plan beneficiaries do "not stand in the same position with respect to the *attorney*, for whom the work product rule was designed to benefit," as they do to plan fiduciaries. *Donovan v. Fitzsimmons*, 90 F.R.D. 583, 2 EBC 1393 (N. D. Ill. 1981) (emphasis added). *Accord*, *Helt v. Metropolitan District Commission*, 113 F.R.D. 7, 7 EBC 2617 (D. Conn. 1986); *Wildbur v. Arco Chemical Co.*, 974 F.2d 631, 16 EBC 1235 (5th Cir. 1992). But see, *Redd v. Bhd. Of Maintenance of Way Employees Div. of the Int'l Bhd. Of Teamsters*, 2009 U.S. Dist. LEXIS 46288 (E.D. Mich. 2009) (concluding that courts have found that the fiduciary exception may overcome the work product privilege "at least as to materials prepared in the 'pre-decisional' phase of a benefit determination"; the court cited *Lewis*, 203 F.R.D. at 623, and *Geissal*, 192 F.R.D. at 625, for support, characterizing the holdings in *Lewis* and *Geissal* as involving a fiduciary exception to the work product privilege; in fact, though, the courts in those decisions concluded that there was no work product privilege because the communications were not "in anticipation of" litigation); *Fortier v. Principal Life Ins. Co.*, 2008 U.S. Dist. LEXIS 43108 (E.D. N.C. 2008) (stating, *in dicta*, that a fiduciary exception applies to the work product doctrine in some circuits, citing to two opinions collected in *Tatum*, 247 F.R.D. at 493); *Harvey v. Standard Ins. Co.*, 2011 U.S. Dist. LEXIS 107834, 53 EBC 2185 (N.D. Ala. 2011) (applied the fiduciary exception to work product doctrine).

C. **"Substantial Need" Exception**. Although most courts have concluded there is no "good cause" exception to the work product doctrine, Federal Rule of Civil Procedure 26(b)(3) permits the discovery of documents otherwise subject to work product immunity where the party seeking discovery has "substantial need" of the materials in preparation of the party's case and the party is unable "without undue hardship" to obtain the substantial equivalent by other means. For example, where fiduciaries allege they acted appropriately and did not breach their fiduciary duties because they acted upon "advice of counsel," participants or the Department of Labor may have an opportunity to discover documents relating to that advice. *See, e.g.*, *Donovan v. Fitzsimmons*, 90 F.R.D. 583 (N.D. Ill. 1981).

D. **"Dual Purpose" Documents: Tax Advice - IRS' Discovery Relating to Tax Accrual Work Papers**. In a 3-2 decision, an *en banc* panel of the First Circuit concluded that the work product doctrine did not shield from an IRS summons "tax accrual work papers" prepared by attorneys and others in a company's tax department. These were papers prepared to support the company's calculation of tax reserves for its audited corporate financial statements. *U.S. v. Textron Inc.*, 577 F.3d 21 (1st Cir. 2009).

The decision is notable in a several ways. First, the district court had concluded that any attorney-client privilege that may have existed was waived when the company disclosed the work papers' contents to its independent accountants. The appeals court apparently was not asked to review this holding.

The bulk of the appellate court decision dealt with the work product doctrine. The First Circuit concluded that the work papers were independently required by statutory and audit requirements, and largely for that reason the work product privilege did not apply. The court summed up its ruling as follows:

> [T]he work product privilege is aimed at protecting work done for litigation, not in preparing in financial statements. Textron's work papers were prepared to support financial filings and gain auditor approval; the compulsion of the securities laws and auditing requirements assure that they will be carefully prepared, in their present form, even though not protected . . . .

"Prepared for Litigation" Standard (as opposed to "Because of Litigation" Standard. A vigorous dissenting opinion accused the majority of changing the work product standard in the First Circuit as it relates to dual purpose documents – that is, documents having a business purpose, but also prepared in anticipation of litigation. The dissent claimed that the court had abandoned its previous precedent in *Maine v. U.S. Dept. of Interior*, 298 F.3d 60 (1st Cir. 2002), in which the court had been influenced by the Second Circuit's decision in *U.S. v. Adlman*, 134 F.3d 1194 (2d Cir. 1998). In *Maine*, which the dissent characterized as establishing a "because of" test, the proper inquiry was whether "in light of the nature of the document and the factual situation in the particular case, the document can be fairly said to have been prepared or obtained because of the prospect of litigation." 298 F.3d at 68 (emphasis in original) (quoting *U.S. v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998)). The dissent argued that the majority had replaced this test with a "prepared for" test, under which one must ask whether the documents were "prepared for use in possible litigation." The dissent criticized this as being an even narrower privilege than a Fifth Circuit standard the court had previously rejected as being overly narrow, under which the work product doctrine protects documents only if they are "primarily motivated to assist in future litigation." (emphasis added) (quoting from *U.S. v. El Paso*, 682 F.2d 530, 542-43 (5th Cir. 1982), which itself cited *U.S. v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981)).

The dissent noted that the tax accrual work papers at issue included estimates by Textron's counsel expressing, in percentage terms, their judgments regarding Textron's chances of prevailing in any litigation over tax positions that might be challenged by the IRS. The dissent said there would have been no need to create a tax reserve if Textron had not anticipated a dispute with the IRS that was likely to result in litigation or some other adversarial proceeding.

The dissent warned that the majority's decision will result in attorneys who identify "good faith questions and uncertainties in their clients' tax returns" being more likely to avoid putting those concerns in writing, thereby diminishing the quality of their representation. This will be the result, the dissent predicted, because providing such information in writing will result in discovery by the IRS. The dissent noted, in this regard, that although the law required that Textron prepare audited financial statements reporting total reserves based on contingent tax liabilities, and the accounting standards require some evidential support before those statements can be certified, the accounting standards do not explicitly require the form and detail of documents prepared by Textron's attorneys with respect to each potentially challenged tax item. Instead, all that must be actually reported is the company's final tax reserve liability amount.

The dissent said these concerns are all the more worrying because the majority's decision will remove protection not only for the company's work papers, but also for "back up materials." In *Textron* these materials included "notes and memoranda written by Textron's in-house tax attorneys reflecting their opinions as to which items should be included on the spreadsheet and the hazard of litigation percentage that should apply to each item." The dissent said these documents involved not simply numbers used to compute a total reserve, but in fact explained the legal rationale underpinning the company's views of its litigation chances. In essence, requiring disclosure of these papers would permit one party to litigation, the IRS, to discover an opposing party's analysis of the business risks of that litigation, including the amount of money set aside in a litigation reserve fund.

Most strikingly, the dissent argued that the general application of the new rule announced by the majority is that there will be no protection for documents analyzing anticipated litigation, if those documents are prepared to assist in a business decision rather than to assist in the conduct of the litigation. The court continued, as follows:

> Nearly every major business decision by a public company has a legal dimension that will require such analysis [of anticipated litigation]. Corporate attorneys preparing such analyses should now be aware that their work product is not protected in this circuit.

Majority's Recitation of Facts. To give the reader full context of the dispute, here is the majority's rather nice statement of the facts:

> The question for the *en banc* court is whether the attorney work product doctrine shields from an IRS summons "tax accrual work papers" prepared by lawyers and others in Textron's Tax Department to support Textron's calculation of tax reserves for its audited corporate financial statements. Textron is a major aerospace and defense conglomerate, with well over a hundred subsidiaries, whose consolidated tax return is audited by the IRS on a regular basis. To understand the dispute, some background is required concerning financial statements, contingent tax reserves and tax audit work papers.
>
> As a publicly traded corporation, Textron is required by federal securities law to have public financial statements certified by an independent auditor. See 15 U.S.C. §§ 781, 78m (2006); 17 C.F.R. § 210 *et seq*. (2009). To prepare such financial statements, Textron must calculate reserves to be entered on the company books to account for contingent tax liabilities. Such liabilities, which affect the portrayal of assets and earnings, include estimates of potential liability if the IRS decides to challenge debatable positions taken by the taxpayer in its return.
>
> The calculation of such reserves entails preparing work papers describing Textron's potential liabilities for further taxes; these underpin the tax reserve entries in its financial statement and explain the figures chosen to the independent auditor who certifies that statement as correct. By examining the work papers the accountant discharges its own duty to determine "the adequacy and reasonableness of the corporation's reserve account for contingent tax liabilities." *United States v. Arthur Young & Co.*, 465 U.S. 805, 812, 104 S. Ct. 1495, 79 L. Ed. 2d 826 (1983) (rejecting claim of accountant work product privilege protecting such work papers).[1] The work papers are thus one step in a process whose outcome is a certified financial statement for the company.
>
> > 1 The procedural requirement that auditors examine tax accrual work papers is based on a combination of Statement on Auditing Standards No. 96, Audit Documentation (2002), *superseded by* Auditing Standards

No. 3, Audit Documentation (2004); Statement on Auditing Standards No. 326, Evidential Matter (1980); and Auditing Interpretation No. 9326, Evidential Matter: Auditing Interpretations of Section 326 (2003).

In Textron's case, its Tax Department lists items in the tax return that, if identified and challenged by the IRS, could result in additional taxes being assessed. The final spreadsheets list each debatable item, including in each instance the dollar amount subject to possible dispute and a percentage estimate of the IRS' chances of success. Multiplying the amount by the percentage fixes the reserve entered on the books for that item. The spreadsheets reflecting these calculations may be supported by backup emails or notes.

A company's published financial statements do not normally identify the specific tax items on the return that may be debatable but incorporate or reflect only the total reserve figure. As the Supreme Court explained in *Arthur Young*, tax accrual work papers provide a resource for the IRS, if the IRS can get access to them, by "pinpoint[ing] the 'soft spots' on a corporation's tax return by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes" and providing "an item-by-item analysis of the corporation's potential exposure to additional liability." 465 U.S. at 813.

The IRS does not automatically request tax accrual work papers from taxpayers; rather, in the wake of Enron and other corporate scandals, the IRS began to seek companies' tax accrual work papers only where it concluded that the taxpayer had engaged in certain listed transactions "that [are] the same as or substantially similar to one of the types of transactions that the [IRS] has determined to be a tax avoidance transaction." 26 C.F.R. § 1.6011-4(b)(2) (2009). Only a limited number of transactions are so designated.[2]

2 A current list of such transaction types, amounting to less than three dozen, appears at Internal Revenue Service, Recognized Abusive and Listed Transactions - LMSB Tier I Issues, http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html (visited July 7, 2009).

The present case began with a 2003 IRS audit of Textron's corporate income tax liability for the years 1998-2001. In reviewing Textron's 2001 return, the IRS determined that a Textron subsidiary - Textron Financial Corp. ("Textron Financial")

- had engaged in nine listed transactions. In each of the nine instances, Textron Financial had purchased equipment from a foreign utility or transit operator and leased it back to the seller on the same day. Although such transactions can be legitimate, the IRS determined that they were sale-in, lease-out ("SILO") transactions, which are listed as a potential tax shelter subject to abuse by taxpayers.

SILOs allow tax-exempt or tax-indifferent organizations - for example, a tax-exempt charity or a city-owned transit authority - to transfer depreciation and interest deductions, from which they cannot benefit, to other taxpayers who use them to shelter income from tax. Where the only motive of a sale and lease back is tax avoidance, it can be disregarded by the IRS and taxes assessed on the wrongly sheltered income.[3]

> 3 *See AWG Leasing Trust v. United States*, 592 F. Supp. 2d 953, 958 (N.D. Ohio 2008) (upholding denial of depreciation and interest deductions for SILO transaction); I.R.S. Notice 2005-13, 2005-9 I.R.B. 630 (Feb. 11, 2005); Shvedov, *Tax Implications of SILOs, QTEs, and Other Leasing Transactions with Tax-Exempt Entities* 10-12, CRS Report for Congress (Nov. 30, 2004).

Textron had shown the spreadsheets to its outside accountant, Ernst & Young, but refused to show them to the IRS. The IRS issued an administrative summons pursuant to 26 U.S.C. § 7602 (2006), which allows the IRS, in determining the accuracy of any return, to "examine any books, papers, records, or other data which may be relevant or material to such inquiry." *Id*. § 7602(a)(1). According to IRS policy, where the taxpayer claims benefits from only a single listed transaction, the IRS seeks only the workpapers for that transaction; but where (as in Textron's case) the taxpayer claims benefits from multiple listed transactions, the IRS seeks all of the workpapers for the tax year in question. I.R.S. Announcement 2002-63, 2002-27 I.R.B. 72 (July 8, 2002). The summons also sought related work papers created by Ernst & Young in determining the adequacy of Textron's reserves that Textron might possess or could obtain. Textron again refused.

The IRS brought an enforcement action in federal district court in Rhode Island. See 26 U.S.C. § 7604(a) (2006). Textron challenged the summons as lacking legitimate purpose and also asserted, as bars to the demand, the attorney-client and tax practitioner privileges and the qualified privilege available for litigation materials under the work product doctrine. The IRS contested all of the privilege claims. Both the IRS and Textron filed affidavits and, in addition, the district court heard witnesses from both sides.[4]

> 4 Textron's evidence came from Norman Richter, chief tax counsel and manager of Textron's Tax Department; Roxanne Cassidy, director of tax reporting; Edward Andrews, director of tax audits; Debra Raymond, vice president, taxes, of Textron Financial; and Mark Weston, a partner in Ernst & Young. IRS evidence was provided by Internal Revenue Agent Edward Vasconcellos; Professor Douglas Carmichael, former chief auditor of the regulatory body for auditors of public companies (the Public Company Accounting Oversight Board); and Gary Kane, an IRS expert on tax accrual work papers.

Textron agreed that it usually settled disputes with the IRS through negotiation or concession or at worst through the formal IRS administrative process; but it testified that sometimes it had litigated disputed tax issues in federal court. Its evidence also showed that the estimates for tax reserves and the supporting work papers were generated within its Tax Department but that tax lawyers in that department were centrally involved in their preparation and that Textron Financial also used an outside counsel to advise it on tax reserve requirements.

Textron described generically the contents of the work papers in question: these included (1) summary spreadsheets showing for each disputable item the amount in controversy, estimated probability of a successful challenge by the IRS, and resulting reserve amounts; and (2) back up e-mail and notes. In some instances the spreadsheet entries estimated the probability of IRS success at 100 percent. Textron said that the spreadsheets had been shown to and discussed with its independent auditor but physically retained by Textron.

Neither side disputed that the immediate purpose of the work papers was to establish and support the tax reserve figures for the audited financial statements. Textron's evidence was to the effect that litigation over specific items was always a possibility; the IRS did not deny that in certain cases litigation could result although it said that this was often unlikely. Whether Textron's evidence is materially different than that of the IRS remains to be considered.

The D.C. Circuit also has considered the application of the work product doctrine to materials produced by a company's independent auditor. In *U.S. v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010), the court considered whether a company's independent auditor must produce three documents in connection with ongoing tax litigation between the company and the IRS. The IRS argued that one of the documents was not work product because it was prepared by the auditor, Deloitte, during the audit process. In addition, although the IRS conceded that the other two documents were work product, it argued that the company, Dow Chemical, waived work-product protection when it disclosed those documents to Deloitte.

The three disputed documents were (a) a draft memorandum prepared by Deloitte that summarized a meeting between Dow employees, Dow's outside counsel, and Deloitte employees about the possibility of litigation over a tax matter and the necessity of accounting for that possibility in an ongoing audit, (b) a memorandum and flow chart prepared by two Dow employees – an accountant and an in-house attorney, and (c) a tax opinion prepared by Dow's outside counsel. The second and third of these documents were disclosed to Deloitte so it could "review the adequacy of Dow's contingency reserves" for the transactions at issue. According to Dow's Director of Taxes, Deloitte "compelled Dow's production of these documents by informing the company that access to these documents was required in order to provide Dow with an unqualified audit opinion for its public financial statements."

The government argued that the first of the documents, the draft memorandum prepared by Deloitte, could not be work product for two reasons. First, it argued that it could not be work product because it was created by Deloitte, not Dow or its representative. Second, it argued that the memorandum could not be work product because it was generated as part of the routine audit process, not in anticipation of litigation. The D.C. Circuit rejected both of these arguments, but concluded that the district court lacked sufficient information to determine that the entire memorandum was work product.

As to the ability of the document created by Deloitte to constitute work product, the court said "the question is not who created the document or how they are related to the party asserting work-product protection, but whether the document contains work product – the thoughts and opinions of counsel developed in anticipation of litigation." The court concluded that the memorandum generated during the annual audit was being prepared "in anticipation of litigation" under the "because of" standard, under which work product applies where a document was "prepared or obtained because of the prospect of litigation."

The court then considered whether the two documents prepared by Dow, but disclosed to Deloitte, lost their work-product protection by reason of that disclosure. The IRS conceded that these latter two Dow documents were work product, but contended that Dow waived work-product protection by disclosing them to Deloitte. The D.C. Circuit said to the best of its knowledge, no Circuit had addressed whether disclosing work product to an independent auditor constituted a waiver. It observed, however, that most district courts addressing the issue have found no waiver in that circumstance. The court stated that "while voluntary disclosure waives the attorney-client privilege, it does not necessarily waive work-product protection." The disclosure of work product to a third party can waive protection if "such disclosure, under the circumstances, is inconsistent with the maintenance of secrecy from the disclosing party's adversary." The court concluded that while there may be "tension between an auditor and a corporation that arises from an auditor's need to scrutinize and investigate a corporation's records and book-keeping practices" (quoting *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc*., 229 F.R.D. 441, 448 (S.D. N.Y.)), the possibility of a future dispute between Deloitte and Dow did not render Deloitte a potential adversary for the purpose of determining whether the work-product protection had been waived. The court concluded that there was no waiver of work product privilege because the auditor was not an adversary in the sense necessary to work a waiver.

Three Standards for Whether Materials are Prepared in "Anticipation of Litigation." As noted above, the dissent in *Textron* characterized the First Circuit's new test for determining whether materials are prepared in "anticipation of litigation" – so they can enjoy work product privilege – as being a "prepared for" litigation standard. This is different from the "because of" test applied by the Second, Fourth, Seventh, Eighth, and D.C. Circuits. Under the "because of" test, work product applies where the document was "prepared or obtained because of the prospect of litigation." *U.S. v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998). See also *Nat'l Union Fire Ins. Co. v. Murray Sheet Metal Co.*, 967 F.2d 980, 984 (4th Cir. 1992); *Bink Mfg. Co. v. Nat'l Presto Indus. Inc.*, 709 F.2d 1109, 1118-19 (7th Cir. 1983); *Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987); *Senate of Puerto Rico v. U.S. Dep't. of Just.*, 823 F.2d 574, 586 (D.C. Cir. 1987). Under this "because of" standard, a document may serve an additional purpose other than preparation for litigation, and yet be work product. The Fifth Circuit has adopted a "primary purpose" test, under which the work product doctrine protects documents only if they are "primarily motivated to assist in future litigation." (Emphasis added.) *U.S. v. El Paso*, 682 F.2d 530, 542-43 (5th Cir. 1982), citing *U.S. v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981).

VI. **Miscellanea**.

A. Counsel for Plan Participant: Handling Settlement Proceeds Subject to Subrogation Claim. A federal district court held that an attorney did not violate the Arizona Rules of Professional Conduct when the attorney disbursed to his client, a health plan participant, $105,000 in proceeds from the settlement of a claim with GMAC arising in connection with the client's injury in an automobile accident. *Employers Reinsurance Corporation v. GMAC Insurance*, 308 F. Supp. 2d 1010, 33 EBC 1242 (D. Ariz. 2004). During the course of the participant's settlement negotiations with GMAC, a reinsurance company, as assignee of the health plan that paid the participant's medical bills, asserted its claim to the settlement proceeds. The attorney responded to the reinsurer's assertions by offering a settlement. The reinsurer rejected the participant's offer. Counsel for the participant then stated in a letter to the reinsurer his position that the reinsurer had "no contractual rights of subrogation or reimbursement under ERISA," (citing the U.S. Supreme Court's decision in *Great-West Life & Annuity Insurance Co. v.*

Knudson, 534 U.S. 204, 27 EBC 1065 (2002)). The attorney invited the reinsurer to provide legal authority to the contrary, and stated in his letter "[i]f you have any legal authority in the 9th Circuit which contradicts these cases [*Knudson* and its progeny], I would be very interested in reviewing that authority. However, in the absence of such authority, your company does not have any claims to these funds." The reinsurer did not provide the attorney with any such authority.

The day GMAC disbursed the $105,000 to the participant's counsel, the reinsurer filed an action against the participant and her attorney in federal district court, asserting claims under ERISA's enforcement provisions and moving for a preliminary injunction. The court denied the motion, citing *Knudson* for the proposition that the reinsurer had no federal claim. In response, the reinsurer voluntarily dismissed its federal court action and filed an action asserting its claims under state law, naming the attorney and GMAC as defendants, but not the participant.

As one of its claims against the attorney, the reinsurer asserted that the attorney intentionally interfered with the reinsurer's contractual rights by distributing GMAC settlement proceeds to himself and the participant. One of the elements of the tort of intentional interference is that the attorney's actions have been "improper." It is in this context that the court considered the application of the Arizona Rules of Professional Conduct. The reinsurer argued that the attorney's interference with the reinsurer's contractual relations was improper because it violated Arizona Rule of Professional Conduct E.R. 1.15, which provides that a lawyer should segregate and hold disputed property, and file an interpleader action where the dispute cannot be resolved amicably. The court concluded, however, that there is no violation of this standard where the lawyer actually has a reasonable, good faith belief that the third party's claim is without substantial merit. The court concluded that the attorney did have such a reasonable, good faith belief by reason of the Supreme Court precedent in *Knudson*, and because potential state law claims had not yet been asserted at the time the proceeds were disbursed by the attorney. If the state law claims had been asserted at that point, the court indicated that the outcome might have been different (that is, it might have been improper for the attorney to have disbursed the funds at the time he did so).

Following a health plan's successful claim for reimbursement from settlement proceeds a participant recovered from a third party tortfeasor, the Seventh Circuit refused to grant the plan's claim against the participant's attorney for attorneys' fees pursuant to 28 U.S.C. § 1927. *Bender v. Freed*, 436 F.3d 747, 36 EBC 2510 (7th Cir. 2006). The cited provision authorizes a district court to award attorneys' fees as a sanction against an attorney who unreasonably and vexatiously multiplies the proceedings before the court. The health plan was prompted to make its claim for fees because, prior to the current litigation, the participant had settled with the third party tortfeasor's insurance company for its policy limit of $50,000 and distributed those monies between the participant and his attorney, without the attorney informing the plan that the insurer had paid a settlement.

Under the terms of the plan, the plan retained a subrogated interest in any damages the participant might recover after the plan's payment of medical expenses relating to the participant's automobile accident.

Importantly, the participant's attorney's failure to inform the plan of the insurer's payment of the settlement occurred prior to the instant litigation. For this reason, the court concluded that 28 U.S.C. Section 1927 did not apply, because the complained of actions related solely to the attorney's pre-litigation conduct, rather than a vexatious multiplication of the current litigation (the current litigation arose when the participant and his wife sued the tortfeasor, following settlement with the tortfeasor's insurer, and sued the plan for a declaration that it was not entitled to reimbursement). As part of the plan's argument for a Section 1927 sanction, it asserted that the attorney's conduct constituted a violation of a professional duty imposed by the Rules of Professional Conduct governing attorneys in Wisconsin. In particular, the plan cited Wisconsin Supreme Court Rule 20:1.15(d)(1), which requires an attorney who receives funds in which a client or a third person has an interest to "promptly notify the client or third person in writing" and to "promptly deliver to the client or third person any funds . . . that the client or third person is entitled to receive." The court noted that Section 1927 does not provide a generalized substantive remedy for attorney misconduct, but instead provides only a remedy for bad faith misconduct by an attorney in the pursuit of a case in court. The court did not comment on whether the attorney had violated the rules of professional conduct governing attorneys in Wisconsin, but held simply that Section 1927 would not allow the court to award attorneys' fees as a sanction against an attorney by reason of his or her pre-litigation behavior.

B. <u>Duty to Notify Client of Mistake</u>.

The ABA Model Rules of Professional Conduct (the "Model Rules") provide, in subsection (b) of Rule 1.4, which is captioned "Communications," as follows:

> A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Model Rule 1.7, which is captioned "Conflict of Interest: Current Clients," provides, in Subsection (a)(2), as follows:

> [A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> * * * * *
>
> 2. there is a significant risk that the representation of one or more clients will be materially limited by . . . a personal interest of the lawyer.

Some commentators are of the view that Model Rule 1.4 requires an attorney to advise her or his client of a mistake made by the attorney in representing the client as soon as the attorney has had an opportunity to analyze the importance of the mistake and its consequences. A case sometimes cited for this proposition concerns the failure of a law firm, in reviewing a settlement agreement concerning a rent dispute under a lease, to correctly review rent calculations. The case is *Circle Chevrolet Co. v. Giordano, Halleran & Ciesla*, 662 A.2d 509 (N.J. 1995), *overruled on other grounds, Olds v. Donnelly*, 696 A.2d 633 (N.J. 1997). The court in *Circle Chevrolet* looked to the New Jersey Rules of Professional Conduct that are similar to Model Rules 1.4(b) and 1.7(a)(2), and stated as follows:

> [A]n attorney who realizes he or she has made a mistake must immediately notify the client of the mistake as well as the client's right to obtain new counsel and sue the attorney for negligence.

For other cases and state ethics opinions reaching a similar conclusion – that is, that an attorney has an obligation to report to clients certain errors, and to report to the client that the attorney may have committed malpractice – see New Jersey Ethics Opinion 694 ("the Rules of Professional Conduct require an attorney to notify the client that he or she may have a legal malpractice claim even if notification is against the attorney's own interest"); Wisconsin Ethics Opinion E-82-12 ("[a]n attorney is obligated to inform his or her client that an omission has occurred which may constitute malpractice and that the client may have a claim against him or her for such omission"); New York State Bar Association Opinion 734, 2000 WL 33347720 (N.Y. St. Bar Assn. Comm. Prof. Eth. 2000) (an attorney "has an obligation to report to the client that it has made a significant error or omission that may give rise to a possible malpractice claim. In such a situation, the [law firm] will be required to withdraw as counsel if its continued representation would be adversely affected by its interest in avoiding civil liability."). See also Restatement (3d) of the Law Governing Lawyers § 20, cmt. C (a lawyer should inform the client of a conflict of interest and "[i]f the lawyer's conduct of the matter gives the client a substantial malpractice claim against the lawyer, the lawyer must disclose that to the client"); *Matter of Discipline of Schmidt*, 402 N.W.2d 544, 550 (Minn. 1987) ("the attorney has the affirmative obligation before taking a liability release from a client to advise the client of the client's right to seek other counsel and to advise the counsel as to the nature and existence of any potential claim"); *Tallon v. Comm. on Prof'l Standards*, 86 A.D.2d 897, 447 N.Y.S.2d 50, 51 (1982) ("an attorney has a professional duty to properly notify his client of his failure to act and of the possible claim his client may thus have against him").

For a more nuanced discussion concerning the potential for <u>legal malpractice liability</u> for failure to disclose an error, see the Eighth Circuit's decision in *Leonard v. Dorsey & Whitney LLP*, 553 F.3d 609 (8th Cir. 2009). In *Leonard*, the court reversed a district court decision that a law firm had committed legal malpractice and breached fiduciary duties owed to a client. In the course of doing so, the court discussed an attorney's duty to disclose a possible malpractice claim to a client, and whether a failure to make such a disclosure would give rise to a cause of action for legal malpractice. The Eighth Circuit applied Minnesota law and held that the law firm defendant was not liable because the court predicted that the Minnesota Supreme Court would not hold a lawyer liable for failure to disclose a possible malpractice claim unless the potential claim created a conflict of interest that would disqualify the lawyer from representing the client, and there was no such disqualifying conflict of interest in the case at hand.

In explaining its decision, the court made a number of observations concerning the duty to disclose a possible malpractice claim to a client. In particular, in discussing whether there is a cause of action for legal malpractice (as opposed to a breach of an ethics rule), the court stated the following:

> A lawyer's common-law duty to disclose a possible malpractice claim that his client may have against him is a "corollary of the fiduciary obligations of undivided loyalty and confidentiality" the lawyer owes to his client. 2 Ronald E. Mallen & Jeffrey M. Smith, Legal Malpractice § 15:22 at 783 (2008 ed.).
>
> * * * * *
>
> [T]here are two aspects of this legal duty. First, the client is entitled to know of any fact that may limit the lawyer's ability to comply with the fiduciary obligations. Id. Second, the client is entitled to be informed of any acts or events over which it has control. Id. By definition, only the first aspect of this duty implicates the lawyer's fiduciary obligations to his client; the second arises from the lawyer's professional standards.
>
> A classic example of a duty to advise a client of potential malpractice is a lawyer who fails to file a lawsuit for a client within the limitations period. See *Restatement (Third) of the Law Governing Lawyers, § 20, cmt. C* (2000).
>
> * * * * *
>
> "Disclosure should be made if the failure to do so could reasonably be expected to prejudice the client's continued representation." [Quoting Mallen & Smith, above]
>
> * * * * *
>
> We predict that the Minnesota Supreme Court would not hold a lawyer liable for failure to disclose a possible malpractice claim unless the potential claim creates a conflict of interest that would disqualify the lawyer from representing the client.
>
> * * * * *

> ("[T]here is no civil cause of action for a lawyer's failure to confess legal malpractice, which consists simply of nondisclosure of prior negligent conduct, unless there was an independent tort or risk of additional injury."). [Quoting Mallen & Smith, above] Thus, the lawyer must know that there is a non-frivolous malpractice claim against him such that "there is a substantial risk that the lawyer's representation of the client would be materially and adversely affected by" his own interest in avoiding malpractice liability. See *Restatement (Third) of the Law Governing Lawyers §§ 121*, *125*.

* * * * *

[A] lawyer's duty to disclose his own errors must somehow be connected to a possibility that the client might be harmed by the error. For a fiduciary duty to be implicated, the lawyer's own interests in avoiding liability must conflict with those of the client. A lawyer may act in the client's interests to prevent the error from harming the client without breaching a fiduciary duty.

C. **Plan Participants' Ability to Sue Law Firm for Legal Malpractice; Law Firm as Fiduciary of Client's Plan.** A federal district court concluded that a plan participant could not maintain an action for legal malpractice against a law firm that provided advice to the plan sponsor concerning the plan. The court also found that the law firm was not a fiduciary of its client's retirement plan. *Clark v. Feder Semo & Bard*, *P.C.*, 634 F. Supp. 2d 99, 47 EBC 2808 (D. D.C. 2009). The plan was itself sponsored by a law firm, and the plaintiff was a former attorney of the sponsoring law firm. In fact, the plaintiff had been the managing partner of the firm for a time. After leaving the law firm (the firm that was the plan sponsor, not the firm that provided the legal advice), the plaintiff complained that the firm had violated the "top 25 employee" distribution rules of Treasury Regulation Section 1.401(a)(4)-5(b)(3). Under those rules, distributions to certain participants may not be made faster than a straight life annuity (plus a Social Security supplement, if any, under the plan), if the value of the plan's assets is not at least 110 percent of the value of current liabilities. These restrictions apply to distributions to highly compensated employees or former highly compensated employees who are among the 25 nonexcludible employees and former employees with the largest compensation in the current or any prior year. (This rule remains in place, at least for the time being, despite the benefit restriction rules of IRC Section 436, added by the Pension Protection Act of 2006, which one might argue serve the same goal as that of the "top 25 employee" pre-PPA Treasury regulations – that is, making sure that an underfunded plan, upon termination, does not favor highly compensated employees (and former highly compensated employees) in making distribution of plan assets.) There are exceptions and subtleties to the rule, including an exception where the value of benefits payable to the top 25 employee is less than one percent of the value of current liabilities prior to distribution.

Although the plaintiff in *Clark* also complained that her benefit had been miscalculated, it appears the thrust of her complaint was that benefits had been paid to the founder and principal owner of the firm (and to his wife) upon the founder's retirement in lump sum payments that violated the top 25 employee rules. These distributions were important because, according to the plaintiff's allegations, in September 2005, after the firm's largest client filed a professional malpractice suit against the firm, the retirement plan was terminated. At that time, the plaintiff contended, the plan was underfunded by more than $1.1 million, and as a consequence participants in the plan, including the plaintiff, received only 53 percent of the present value of their retirement benefits.

The plaintiff filed suit against her former law firm, the retirement plan, and two individual plan trustees, alleging that they violated ERISA by reducing or eliminating her accrued benefits, failing to disclose the plan's lack of insurance, and breaching their fiduciary duties. Defendants filed a counterclaim for contribution and indemnity under ERISA and federal common law, alleging that the plaintiff herself was a fiduciary of the plan for a period of time, during which time she oversaw and approved the distribution of the largest of the lump sum distributions (approximately $780,000). The defendants' counterclaim asserted, therefore, that the plaintiff was responsible for any breach or violation relating to that distribution.

The plaintiff, in response to the counterclaim, filed a third party complaint against a law firm that had advised the plaintiff's prior firm, as well as against an actuarial firm, alleging violations of ERISA and professional malpractice. The court dismissed the claims against the law firm – that is, against the firm that provided the retirement plan advice. As to the ERISA fiduciary claims, the plaintiff argued that the advising law firm knowingly participated in fiduciary breaches such that it functioned as a co-fiduciary with respect to the retirement plan. The court held that the advising law firm was not a fiduciary, despite the plaintiff's allegations that (a) her old firm had, in a letter to her, advised her to contact the advising law firm directly if she had questions about the retirement plan termination process, (b) the advising law firm had signed a letter denying the plaintiff's appeal for benefits calculations, (c) an attorney at the advising law firm decided to overlook an error made in calculating the plaintiff's benefits, and (d) her old firm simply followed the advice of the advising law firm, and thereby ceded authority to it.

The court rejected the notion that following the law firm's advice on retirement plan matters would, itself, make the advising firm a fiduciary. That is, a client's decision to follow a law firm's advice does not cause the law firm's action to rise to the level of discretionary authority. In this regard, the court quoted approvingly from an Eleventh Circuit decision, as follows:

> It cannot plausibly be considered consonant with the clear purpose of ERISA to deprive ERISA plans of access to ordinary legal advice . . . . Equally chilling would be a rule equating a law firm's

> advice in favor of a transaction with the named fiduciaries' actual decision to enter the transaction.

(quoting *Useden v. Acker*, 947 F.2d 1563, 1578 (11th Cir. 1991).) As to the letter denying the plaintiff's appeal, the court noted that it was written on behalf of the client law firm, and the advising law firm's role in explaining the plan termination process did not give it discretionary authority with regard to the plan's management, disposition of its assets, or administration of the plan.

In analyzing her legal malpractice claim, the court considered the plaintiff's argument that the advising law firm's services were "for her benefit." She argued that she could recover from the advising law firm because she was an "intended beneficiary" of the firm's services. The court said under District of Columbia law "with rare exceptions, a legal malpractice claim against an attorney . . . [requires] the existence of an attorney-client relationship." (quoting *Taylor v. Akin, Gump, Strauss, Hauer & Feld*, 859 A.2d 142, 147 (D.C. 2004).) The court said the primary exception to the requirement of an attorney-client relationship is in the narrow class of cases where the intended beneficiary of a will sues the attorney who drafted the will. The few cases applying the intended beneficiary exception outside the will context require that the third party allege more than "mere harm," instead requiring that the plaintiffs allege they were the "direct and intended beneficiar[ies] of the attorney-client relationship."

The court concluded that the plaintiff had not alleged facts sufficient to show she was the direct and intended beneficiary of the advising law firm's services. Instead, her allegations showed only that she was a participant in the retirement plan for which the advising law firm provided legal services. The advising law firm provided services for the benefit of its client law firm, and any benefit the plaintiff received from those services was collateral to the primary relationship between the two law firms.

Clark should, of course, not be read for the proposition that a law firm may never inadvertently become a fiduciary in its representation of a client. A federal district court has, for example, concluded that a law firm became a fiduciary of a plan where the law firm was provided "a virtual open checkbook for expenses" in litigation against an actuarial consulting firm and, more importantly, "rejected, without first conferring with the [Pension] Fund, the $110 million offer of settlement, later accepting a similar offer, and filing a motion to enforce the settlement, all without advising or obtaining approval of the Fund." The court summarized its conclusion by stating that "an attorney with *carte blanche* authority to settle a case is more akin to a fiduciary with discretion over the clients (sic) assets, than an attorney performing the usual professional functions. *Iron Workers Local 25 Pension Fund v. Watson Wyatt & Co.*, 2009 U.S. Dist. LEXIS 102939, 48 EBC 1051 (E.D. Mich. 2009).

D. **<u>Attorney's Fraud Conviction in Connection with Davis-Bacon Scheme</u>.** A federal district court upheld criminal fraud charges (for mail fraud, wire fraud, and money laundering) against an attorney who advised several contractors on matters relating to the employee benefit requirements of the Davis-Bacon Act, as well as New York's "Little Davis-Bacon Act." *U. S. v. Coren*, 2009 U.S. Dist. LEXIS 73913 (E.D. N.Y. 2009). In connection with his legal practice, the attorney established a trust fund to which client-contractors could make prevailing fringe benefit payments, as irrevocable contributions to a trustee or a third person under a fund, plan, or program. The attorney served as trustee of the trust. The trust then served as a "benefits bank," funding various types of employee welfare benefits, including health, vacation, and other benefits for certain eligible employees. The companies utilizing the trust signed a participation agreement under which they designated the specific benefit plans they wanted to provide to their employees. Monies in the trust consisted solely of contributions the attorney's client-contractors had certified to state or federal agencies as satisfying their obligation to pay prevailing wage fringe benefits owed to prevailing wage employees.

So far, so good. The problem was that the attorney knew, and in fact intended, that the employer contributions to the trust would not be used exclusively to provide fringe benefits to the prevailing wage employees upon whose behalf credit had been claimed by the clients. Instead, the funds in the trust were used to purchase welfare benefits for company employees without regard to the type of work they performed. In some instances, the benefits paid by the trust were solely, or at least mostly, for the benefit of the owners and operators of the client-companies themselves. The government alleged that the attorney advised, counseled and assisted his client-contractors in using the trust to fraudulently claim to state and federal agencies that they were in full compliance with their prevailing wage obligations, even though a significant portion of the funds contributed to the trust were not used to provide fringe benefits for the workers on whose behalf the contributions had been made and prevailing wage credit received. The attorney, after the first week of a projected five week trial, entered guilty pleas, which he later tried to withdraw. The attempted withdrawal was the subject of the reported decision.

The attorney was also convicted of obstruction of justice. At his plea allocution the attorney admitted to advising an individual, in response to a question the client posed to the attorney, to destroy a computer flash drive containing documents that the attorney advised the individual to remove from his office when the attorney heard that the client's company was under investigation. The attorney admitted that he knew the client would, thereby, be destroying documents that could have been used in a government investigation.

E. **Is a Client Entitled to Everything in the File?** For a very nice survey of the law concerning which items in a file belong to a client, and therefore must be turned over to the client upon its request (perhaps because it is changing counsel), see the article entitled "Whose File Is It Anyway?" by Peter H. Geraghty, which can be found at http://www.abanet.org/media/youraba/200609/article01.html. Geraghty makes a number of points, which he documents well, including the following:

1. What portions of a file a client is entitled to is primarily a question of law, not ethics (or not simply ethics).

2. Almost all authorities agree that a lawyer must provide to the client the "end product," such as "pleadings actually filed in an action; correspondence with a client, opposing counsel and witnesses; and other papers 'exposed to public light by the attorney to further [the] client's interests'; and the final versions of contracts, wills, corporate records and similar records prepared for the client's actual use." (Citations omitted.) See, *e.g.*, *Sage Realty Corp. v. Proskauer Rose Goetz & Mendelsohn*, 689 N.E.2d 879, 881 (N.Y. 1997).

3. Although there is a split in authority, the majority view is that a lawyer must also turn over "work product" (confusingly, this term does not have the same meaning as in the work product privilege context). This would include "all preliminary documents 'used by the lawyer to reach the end result,' such as internal legal memoranda and preliminary drafts of pleadings and legal instruments." (Citation omitted.) *Sage Realty, supra*, at 881; *Oregon State Bar Opinion 2005-125* (would include "all papers and property the client provided, all litigation materials, all correspondence, all items the lawyer has obtained from others, and all notes or internal memorandums that may constitute work product").

4. As the court in *Sage Realty, supra*, put it, a lawyer should, however:

> not be required to disclose documents which might violate a duty of nondisclosure owed to a third party, or otherwise imposed by law (*see, e.g.*, Restatement [3d] of the Law Governing Lawyers, *op. cit.*, § 58, comments). Additionally, nonaccess would be permissible as to firm documents intended for internal law office review and use. "The need for lawyers to be able to set down their thoughts privately in order to assure effective and appropriate representations warrants keeping such documents secret from the client involved" (*Id.*). This might include, for example, documents containing a firm attorney's general or other assessment of the client, or tentative preliminary impressions of the legal or factual issues presented in the representation, recorded primarily for the purpose of giving internal direction to facilitate performance of the legal services entailed in that representation. Such documents presumably are unlikely to be of any significant usefulness to the client or to a successor attorney.

Similarly, Colorado Opinion 104 (1999), concluded that an attorney need not turn over what it called "personal attorney-work product," which it described as "that portion of the file, such as firm administrative documents, conflicts checks, personnel assignments, and personal lawyer notes reflecting attorney impressions, that is not needed to protect the client's interests and, therefore, need not be produced pursuant to [the Colorado professional responsibility code]." *Colorado Bar Association Opinion 104 (1999)*. *Accord*, *Alaska State Bar Opinion 2003-3* ("[A]ccess may be denied to documents intended for internal law office review and use. This might include, for example, preliminary impressions of the legal or factual issues presented in the representation, that are recorded primarily for the purpose of giving internal direction to staff. Access might also be denied to notes relating to the lawyer's impression of the client. These documents may be withheld unless to do so would significantly prejudice the client."); *Oregon State Bar Opinion 2005-125* ("The client is not, however, entitled to any memorandums from other cases that the lawyer may have included in the client's file. Nor is the client entitled to the lawyer's notes bearing on the lawyer-client relationship rather than on the merits of the client's position, for example, a notation that the lawyer has consulted his own counsel to explore potential exposure to discipline or malpractice liability.").

F. Multijurisdictional Practice

1. Model Rule 5.5(d): Services Lawyer is Authorized to Provide Under Federal Law.

The American Bar Association Model Rules of Professional Conduct (the "ABA Model Rules") provide, in Section 5.5(d)(2), as follows:

> A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services in this jurisdiction that:
>
> * * * * *
>
> (2) are services that the lawyer is authorized to provide by federal or other law of this jurisdiction

Note that lawyers who are members in good standing of any state bar are automatically authorized to practice before the Internal Revenue Service under Circular 230. 31 CFR § 10.3(a). The key question under Rule 5.5(d)(2) is what is meant by services that a lawyer is "authorized to provide by federal . . . law . . .." The ABA Report of the Commission on Multijurisdictional Practice (dated August 2002), which proposed the current model rule quoted above (and that was subsequently approved by the ABA's House of Delegates), said in this regard:

> Although this qualification of jurisdictional restrictions would apparently apply to federal prosecutors and federal patent attorneys, among others, the Commission has not undertaken to identify every federal law that authorizes particular work and thereby may preempt state UPL [unauthorized practice of law] laws. Nor has the Commission attempted to identify every state law that specifically authorizes out-of-state lawyers to render particular legal services in the state as an exception to the state's general UPL restriction.

The question, then, is whether a state that has adopted the ABA model would interpret the provision (a) as allowing attorneys to provide advise relating to the tax aspects of employee benefit programs in the state by virtue of their authority to practice before the IRS under Circular 230 (providing written tax advice is considered practicing before the IRS under 31 CFR § 10.30(a)), (b) as requiring a more specific "authorization" under federal law than applies to the tax aspects of employee benefits practice by reason of Circular 230, or (c) more broadly, as allowing anyone with expertise in federal law (such as ERISA and other federal laws affecting employee benefit programs) to provide counsel in the state on those federal law issues.

As of January 24, 2008, it appears that 35 states' highest court had either adopted a rule identical to Model Rule 5.5 or a rule similar to Model Rule 5.5. See American Bar Association Table Concerning State Implementation of ABA Model Rule 5.5 (Multijurisdictional Practice of Law).

2. <u>Model Rule 5.5(c)(4): Temporary Practice in a State</u>.

ABA Model Rule Section 5.5(c)(4) provides as follows:

> A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:
>
> * * * * *
>
> (4) are not within paragraphs (2) or (3) [relating to a lawyer assisted by an attorney licensed in the state, and relating to a pending or potential arbitration, mediation, or other alternative dispute resolution preceding, respectively] that arise

> out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

When the requirements of this provision are met, it would appear that an attorney may give advice within a state in which the attorney is not licensed with respect to both federal and state law (including the law of a state in which the attorney is not admitted). Note, of course, that an attorney must have competence with respect to the law of another state to be permitted to provide advice respecting the law of that state. See ABA Model Rule 1.1.

The key questions under this provision seem to be (a) when advice "arises out of or is reasonably related to" a lawyer's practice in a jurisdiction in which he or she is admitted, and (b) what it means to provide legal services "on a temporary basis" in a state in which the attorney is not licensed.

Comment 14 to Rule 5.5 says the following with respect to the need for the advice to arise out of or be reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted:

> Paragraph . . . (c)(4) require[s] that the services arise out of or be reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted. A variety of factors evidence such a relationship. The lawyer's client may have been previously represented by the lawyer, or may be resident in or have substantial contacts with the jurisdiction in which the lawyer is admitted. The matter, although involving other jurisdictions, may have a significant connection with that jurisdiction. In other cases, significant aspects of the lawyer's work might be conducted in that jurisdiction or a significant aspect of the matter may involve the law of that jurisdiction. The necessary relationship might arise when the client's activities or the legal issues involve multiple jurisdictions, such as when the officers of a multinational corporation survey potential business sites and seek the services of their lawyer in assessing the relative merits of each. **In addition, the services may draw on the lawyer's recognized expertise developed through the regular practice of law on behalf of clients in matters involving a particular body of federal, nationally uniform, foreign, or international law**. Lawyers desiring to provide pro bono legal services on a temporary basis in a jurisdiction that has been affected by a major disaster, but

> in which they are not otherwise authorized to practice law, as well as lawyers from the affected jurisdiction who seek to practice law temporarily in another jurisdiction, but in which they are not otherwise authorized to practice law, should consult the [Model Court Rule on Provision of Legal Services Following Determination of Major Disaster].
>
> (emphasis added)

The American Bar Association Report of the Commission on Multijurisdictional Practice (dated August 2002) which recommended adoption of ABA Model Rule 5.5, said the following with respect to subsection (e)(4) (regarding temporary practice in a state):

> **Model Rule 5.5(c)(4)** would permit, on a temporary basis, transactional representation, counseling and other non-litigation work that arises out of or is reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice. This provision would address legal services provided by the lawyer *outside* the lawyer's state of admission that are related to the lawyer's practice *in* the home state. The provision is drawn from § 3(3) of the Restatement (Third) of the Law Governing Lawyers. The Commission's proposed Comment to Rule 5.5 offers guidance as to its scope and limitations, and it is anticipated that courts and other authorities would provide additional guidance.
>
> This provision is intended, first, to cover services that are ancillary to a particular matter in the home state. For example, in order to conduct negotiations on behalf of a home state client or in connection with a home state matter, the lawyer may need to meet with the client and/or other parties to the transaction outside the lawyer's home state. A client should be able to have a single lawyer conduct all aspects of a transaction, even though doing so requires traveling to different states. It is reasonable that the lawyer be one who practices law in the client's state or in a state with a connection to the legal matter that is the subject of the representation. In such circumstances, it should be sufficient to rely on the lawyer's home state as the jurisdiction with the primary responsibility to ensure that the lawyer has the requisite character and fitness to practice law; the home state has a substantial interest in ensuring that all aspects of the lawyer's provision of legal services,

wherever they occur, are conducted competently and professionally.

Second, this provision would respect preexisting and ongoing client-lawyer relationships by permitting a client to retain a lawyer to work on multiple related matters, including some having no connection to the jurisdiction in which the lawyer is licensed. Clients who have multiple or recurring legal matters in multiple jurisdictions have an interest in retaining a single lawyer or law firm to provide legal representation in all the related matters. In general, clients are better served by having a sustained relationship with a lawyer or law firm in whom the client has confidence. Through past experience, the client can gain some assurance that the lawyer performs work competently and can work more efficiently by drawing on past experience regarding the client, its business, and its objectives. In order to retain the client's business, lawyers representing clients in multiple matters have a strong incentive to work competently, and to engage other counsel to provide legal services work that they are not qualified to render.

Third, **this provision would authorize legal services to be provided on a temporary basis outside the lawyer's home state by a lawyer who, through the course of regular practice in the lawyer's home state, has developed a recognized expertise in a body of law that is applicable to the client's particular matter. This could include expertise regarding nationally applicable bodies of law, such as federal, international or foreign law. A client has an interest in retaining a specialist in federal tax, securities or antitrust law, or the law of a foreign jurisdiction, regardless of where the lawyer has been admitted to practice law**. This could also include expertise regarding the law of the lawyer's home state if that law governs the matter, since a client has an interest in retaining a lawyer who is admitted in the jurisdiction whose law governs the particular matter and who has experience regarding that law. **The provision would, thus, bring the law into line with prevalent law practices. For example, many lawyers who specialize in federal law currently practice nationally, without regard to jurisdictional restrictions, which are unenforced**. The same is true of lawyers specializing in other law that applies across state lines.

To be covered by this provision, the lawyer's contact with any particular host state would have to be temporary. As the California Supreme Court Advisory Task Force noted in its preliminary report on MJP,

> clients often request an out-of-state transactional or other nonlitigating lawyer to come temporarily to [a host state] to provide legal services on a discrete matter. In many circumstances, such conduct poses no significant threat to the public or the legal system, particularly where the attorney is representing a client located in another state [or] has a longstanding relationship with the client . . ..

When a lawyer seeks to practice law regularly in a state, to open an office for the solicitation of clients, or otherwise to establish a practice in the state, however, the state has a more substantial interest in regulating the lawyer's law practice by requiring the lawyer to gain admission to the bar. Although the line between the "temporary" practice of law and the "regular" or "established" practice of law is not a bright one, the line can become clearer over time as Rule 5.5 is interpreted by courts, disciplinary authorities, committees of the bar, and other relevant authorities.

Additionally, for this provision to apply, the lawyer's work in the host state must arise out of or be reasonably related to the lawyer's practice in the home state, so that as a matter of efficiency or for other reasons, the client's interest in retaining the lawyer should be respected. For example, if a corporate client is seeking legal advice about its environmental liability or about its employment relations in each of the twenty states in which it has plants, it is likely to be unnecessarily costly and inefficient for the client to retain twenty different lawyers. Likewise, if a corporate client is seeking to open a retail store in each of twenty states, the client may be best served by retaining a single lawyer to assist it in coordinating its efforts. On the other hand, work for an out-of-state client with whom the lawyer has no prior professional relationship and for whom the lawyer is performing no other work ordinarily will not have the requisite relationship to the lawyer's practice where the matter involves a body of law in which the lawyer does not have special expertise. In the context of

> determining whether work performed outside the lawyer's home state is reasonably related to the lawyer's practice in the home state, as is true in the many other legal contexts in which a "reasonableness" standard is employed, some judgment must be exercised.
>
> (footnotes omitted; emphasis added)

3. **<u>Restatement of the Law Governing Lawyers</u>**

The Restatement of the Law Governing Lawyers provides as follows:

> A lawyer currently admitted to practice in a jurisdiction may provide legal services to a client (1) at any place within the admitting jurisdiction; (2) before a tribunal or administrative agency of another jurisdiction or the federal government in compliance with the requirements for temporary or regular admission to practice before that tribunal, or agency; and (3) at a place within a jurisdiction in which the lawyer is not admitted to the extent that the lawyer's activities arise out of or are otherwise reasonably related to the lawyer's practice under Subsection (1) or (2).

4. **<u>Consequences of Violating State Unauthorized Practice of Law Rules</u>**

1. Possible forfeiture of fees. See, e.g., *Birbrower v. Superior Court*,, 17 Cal. 4th 119 (1998); *Ranta v. McCarney*, 391 N.W.2d 161 (N.D. 1986); *Z.A. v. San Bruno Park School District*, 165 F.3d 1273 (9th Cir. 1999).

2. In some states, potential criminal prosecution under unauthorized practice of law provisions of that state.

3. Professional discipline in state in which licensed.

4. Injunction.

G. **<u>Tax Opinion: Negligent Misrepresentation Standard</u>**

In a topical and interesting opinion, a federal district court dismissed a negligent misrepresentation claim against a law firm. *Berry v. Bryan Cave LLP*, 2010 U.S. Dist. LEXIS 46572, 49 EBC 1080 (N.D. Tex. 2010). The claim concerned a legal opinion relating to a Section 412(i) plan. The plaintiffs were allowed to proceed with their lawsuit based on an allegation of unjust enrichment (that is, the plaintiffs' complaint sufficiently stated an unjust enrichment claim), but various other causes of action, including the claim for negligent misrepresentation, were dismissed.

The putative class action related to the design, marketing, and sale of life insurance policies used to fund defined benefit pension plans. The plaintiffs were generally individual professionals – such as doctors, dermatologists, and business owners – and the business entities they operated. They brought claims against several defendants, including the law firm. The complaint alleged that an opinion letter written by the law firm played a prominent role in the design, marketing, and sale of putative Section 412(i) plans and specially designed life insurance policies used to fund the arrangements.

In September 1999, the firm delivered a legal opinion analyzing a specimen life insurance policy. It delivered this opinion to a pension and financial services firm, which apparently designed the plan. The opinion letter stated that "(a) it was 'more likely than not' that the . . . Plan would be a qualified plan under *section 412(i)* of the Code; (b) it was 'more likely than not' that the specially designed insurance policy . . . or a 'substantially similar policy' issued by another insurance company 'can meet the requirements of *section 412(i)* of the Code' . . . ; and (c) the . . . Plan 'should not be considered a tax shelter.'"

The plaintiffs alleged that this letter made "deliberately vague statements and unsupported legal conclusions," "consciously ignored the tax and legal implications of the underlying scheme," and "[contained] . . . false or misleading statements or omissions." The plaintiffs asserted that the defendants intended for the letter to be relied on by the plaintiffs and others who were similarly situated.

Soon after the IRS issued a press release, two revenue rulings, and proposed regulations in February 2004 indicating that the plan and insurance policies would likely be considered abusive tax shelters, the law firm allegedly sent the pension and financial services firm a memorandum that noted that employers sponsoring abusive 412(i) plans were now required to file Form 8886, which notified the IRS of the employer's participation in an abusive tax shelter. In the memo, the law firm allegedly recommended that employers not file Form 8886 and, instead, file an amended tax return reversing the previous deductions. The plaintiffs alleged that the law firm knew the financial services firm would distribute this memorandum to its clients, including the plaintiffs, and alleged that the financial services firm posted the memo on its website. In January 2005, the law firm allegedly sent the financial services firm a second memorandum, which discussed newly-adopted monetary penalties for not disclosing an abusive tax shelter on Form 8886 but reiterated the previous strategy of filing an amended tax return.

The plaintiffs alleged that in 2005 the IRS began a nationwide audit campaign focused on abusive 412(i) plans, and that the law firm agreed to represent some of the plaintiffs with respect to their IRS audits. The plaintiffs claimed the law firm did not "acknowledge, address, seek, or obtain informed consent" to the conflict of interest from the law firm's involvement in the plan or its simultaneous representation of the financial services company and its agents. The complaint also alleged that the law firm failed to adequately advise the represented plaintiffs of their legal rights as to the IRS audit and against the various defendants, and as a consequence of the IRS audits the plaintiffs had sustained (or will sustain) audit-related fees, penalties, and "significant tax liability."

The court dismissed the negligent misrepresentation claim. In Arizona, negligent misrepresentation occurs when:

> [o]ne who, in the course of business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

The law firm successfully argued that the complaint failed to allege any actionable misrepresentation because the law firm's letters did not contain any false statements (or omissions) of <u>facts</u>. The court said the general rule is that to be an actionable misrepresentation, there must be a misstatement of fact, not of opinion or future conduct. Although the court noted that there are several exceptions to this rule, they do not apply where someone "[relies] on a prediction of future IRS enactment, enforcement, or non-enforcement of the law by someone unaffiliated with the federal government." In these cases, the court said, reliance is inherently unreasonable and an untenable basis for misrepresentation. (The exceptions to the general rule that an actionable misrepresentation must involve a statement (or omission) of fact are: "(1) where a party holds himself out to be specially qualified and the other party is so situated that he may reasonably rely upon the former's superior knowledge; (2) where the opinion is by a fiduciary or other trusted person; [or] (3) where a party states his opinion as an existing fact or as implying facts which justify a belief in the truth of the opinion.")

The law firm letter opined that it was more likely than not that (a) the plan would be qualified under Section 412(i), (b) a specially designed insurance policy or a similar policy could meet the requirements of that section of the Tax Code, and (c) the plan should not be considered a tax shelter. The court said it understood this letter to be predicting future IRS treatment and enforcement of the plan as a qualified 412(i) plan. The court then stated the following:

> Because the Complaint contains no allegations that [the law firm was] in any way affiliated with or had any special knowledge of the IRS, the court concludes that any reliance on the [law firm] Letter was unjustified.

The court therefore granted the law firm's motion to dismiss the negligent misrepresentation count.

H. **Business Associate Agreements with Clients**.

Employee benefits attorneys may, particularly in representing clients with respect to health plans, receive "protected health information" within the meaning of the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). The "Health Information Technology for Economic and Clinical Health Act" (the "HITECH Act") provisions of the American Recovery and Reinvestment Act of 2009 will likely require employee benefits counsel to rethink business associate agreements they may previously have entered into with clients. An attorney may, in that connection, conceivably draft a revised business associate agreement for her or his clients' reconsideration. This may raise ticklish ethical issues, particularly where the attorney has drafted business associate agreements for the client (or its health plans) to use with other business associates. Among the issues this raises are those relating to the law firm's possible interest in negotiating on its own behalf business associate agreement terms that differ from those the firm has recommended the client (or its health plans) attempt to impose on other business associates. The obvious question is how the agreement is to be presented to the client, and to what degree the law firm must disclose its self-interest and the advisability of the client seeking independent legal counsel with respect to the agreement. It seems likely both steps should be taken. One possibility might be to provide in the letter or email transmitting the business associate agreement something akin to the following:

> Because we are a party to the attached agreement, we cannot give you any advice with respect to the agreement's contents. As a result, we strongly suggest that you retain independent legal counsel to review, and advise you with respect to, the agreement.

I. **Requirement that Office be Maintained in State Unconstitutional**. A federal district held the New York statute requiring nonresident attorneys licensed in New York to maintain an office in New York, are not requiring the residents to maintain an office in New York, violates the privileges and immunities clause of the U.S. Constitution. *Schoenefeld v. New York*, 2011 U.S. Dist. LEXIS 100576 (N.D. N.Y. 2011).

J. **Updates to Audit Response Letters**. See the outline at Appendix B for a general discussion of auditor's letters. The Audit Responses Committee of the American Bar Association's Business Law Section has issued a "Statement on Updates to Audit Response Letters" ("Statement on Updates") in *The Business Lawyer*, Vol. 70, Spring 2015, p. 489. This Statement on Updates notes that the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Request (the "ABA Statement") "does not specifically discuss updates to audit response letters." In its recent Statement on Updates, the Audit Responses Committee observed as follows:

> [The ABA Statement] makes clear that lawyers may provide information to auditors only at the request, and with the express

> consent, of their clients. In accordance with the [ABA Statement], lawyers typically indicate in their audit response letters that the information they are furnishing is as of a specified date and disclaim any undertaking to advise the auditor of changes that may later be brought to the lawyer's attention.

The Statement on Updates observes that requests for updates have become standard procedure in recent years for many auditors, in part because of changes to financial reporting standards requiring the issuer of financial statements to evaluate "subsequent events" through the date the financial statements are issued or available to be issued. As a consequence, "most auditors' reports are now dated as of the date the financial statements are issued or are available to be issued, as opposed to the date on which field work is completed." The Statement on Updates observes that requests for updates may also have become more common due to SEC rules requiring that quarterly financial statements be reviewed by external auditors, with auditors in turn choosing to request confirmation from counsel before signing off on the filing of quarterly financial statements with the SEC.

The Statement on Updates says the following about a lawyer's update to an audit response letter:

> As with the initial response letter, a lawyer may only provide information to the auditor at the client's request, even if, as is often the case, the auditor requests the update directly. . . . A lawyer may rely on any form of written request, including electronic mail. The Committee believes that lawyers may also rely on oral requests for an update, though it may be advisable for them to document such request.

K. **Circular 230 Revisions**. The Treasury issued final regulations modifying the standards governing written tax advice at 79 Fed. Reg. 33685 (June 12, 2014). These changes modify the regulations governing practice before the IRS, which are generally found at 31 C.F.R. part 10, and are commonly known as the "Circular 230" rules (because the regulations are reprinted as Treasury Department Circular No. 230). An individual subject to Circular 230 must meet minimum standards of conduct with respect to written tax advice, and those who do not are subject to disciplinary action, including suspension or disbarment as to their ability to practice before the IRS.

The "headline" concerning the new regulations is that they eliminate the "covered opinion" rules that had been found in Section 10.35 (that is, at 31 C.F.R. § 10.35). Those were the rules that led to the ubiquitous use of disclaimers on practitioner communications. Those disclaimers are now no longer required, due to the elimination of the detailed provisions concerning covered opinions and the disclosure of written opinions found in former Section 10.35. Because the amended rules concerning requirements for written advice, which are found primarily in Section 10.37, do not include the old covered opinion disclosure provisions, the "Treasury and the IRS expect that these amendments will eliminate the use of a Circular 230 disclaimer in email and other writings."

Written Tax Advice. New Section 10.37 governs the provision of written advice concerning "Federal tax matters," including the provision of such written advice by means of electronic communication. A "Federal tax matter" is one concerning the application or interpretation of (a) a revenue provision as defined in IRC Section 6110(i)(1)(B), (b) any provision of law impacting a person's obligation under the Internal Revenue laws and regulations, including but not limited to the person's liability to pay tax or obligation to file returns, or (c) any other law or regulation administered by the IRS.

Government submissions on matters of general policy are not considered written advice on a Federal tax matter, nor are continuing education presentations provided to an audience solely for the purpose of enhancing practitioners' professional knowledge on Federal tax matters. Section 10.37(a)(1). The preamble to the regulations indicates that including contact information on a continuing education presentation provided solely for the purpose of enhancing professional knowledge, without more, does not convert an educational presentation into written tax advice governed by Circular 230. The exclusion of continuing education presentations from the definition of a "Federal tax matter" does not, however, apply to presentations marketing or promoting transactions. Section 10.37(a)(1). Even with respect to continuing education presentations, practitioners are to follow the generally applicable diligence and competence standards under Sections 10.22 and 10.35.

A practitioner giving written advice concerning a Federal tax matter must:

1. Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);

2. Reasonably consider all relevant acts and circumstances that the practitioner knows or reasonably should know;

3. Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;

4. Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any person if reliance on them would be unreasonable;

5. Relates applicable law and authorities to facts; and

6. Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

In contrasting the new Section 10.37 rules with the former Section 10.35 covered opinion rules, the preamble to the regulations states new Section 10.37 does not necessarily require a practitioner to describe in the written advice the relevant facts (including assumptions and representations), the application of the law to those facts, and the practitioner's conclusions with respect to the law and the facts. Instead, the scope of the engagement and the type and specificity of the advice sought by the client, coupled with all other appropriate facts and circumstances, are factors in determining the extent to which the relevant facts, application of the laws to those facts, and the practitioner's conclusion with respect to the law and the facts must be set forth in the written opinion. A practitioner may, therefore, consider these factors in determining the scope of written advice. Although the new rules do not explicitly require a recitation of the items above in every written opinion, the preamble indicates that the Treasury and IRS "encourage practitioners to describe all relevant facts, law, analysis, and assumptions in appropriate circumstances," and the determination of whether a practitioner has complied with the requirements of Section 10.37 will be based on all facts and circumstances, "including whether it was appropriate to describe all relevant facts, law, analysis, and assumptions" in the written advice.

Audit Risks. As noted in Item 6 above, written advice concerning a Federal tax matter may not take into account the possibility a tax return will not be audited or that a matter will not be raised on audit. The preamble suggests, although somewhat obliquely, that even when giving oral advice, one may not take into account audit risks. In particular, the preamble says the following with respect to oral advice:

> Treasury and the IRS agree that audit risks should not be considered by practitioners in the course of advising a client on a Federal tax matter, regardless of the form in which the advice is given. Because § 10.37 addresses only written advice, Treasury and the IRS do not believe that the rules barring considerations of the possibility that a return or issue will be audited when giving written advice suggests that it may be considered when giving oral advice.

It appears, however, that a practitioner may, when giving written advice evaluating a Federal tax matter, take into account the possibility that an issue will be resolved through settlement if raised. It appears this is because the Treasury and IRS believe that in giving comprehensive written advice it may be appropriate for a practitioner to inform a client of the "existence or nonexistence of legitimate hazards that may make settlement more or less likely," and that in fact this may be a "material issue for which the practitioner has an obligation to inform the client." (Emphasis added.)

Department of the Treasury | Internal Revenue Service | Office of Chief Counsel

N o t i c e

CC-2009-023

August 3, 2009

Subject: Federal Rule of Evidence 502 **Cancel Date**: Upon incorporation into the CCDM

Purpose

This Notice provides general guidance relating to the provisions of Federal Rule of Evidence 502. The Federal Rules of Evidence, including Rule 502, are applicable in the district courts and in the Tax Court pursuant to section 7453 and Tax Court Rule 143(a).

Introduction

On September 19, 2008, President Bush signed into law S. 2450, a bill adding new Federal Rule of Evidence 502, which applies in all proceedings commenced after the date of enactment and, insofar as is just and practicable, in all proceedings pending as of the date of enactment. The stated objective for the adoption of Rule 502 is to alleviate some of the costs associated with electronic discovery and document production in litigation by reducing the risks associated with inadvertent production of material protected by the attorney-client privilege or the work product doctrine. If an attorney inadvertently discloses information protected by the attorney-client privilege or work product, the new rule creates a presumption for the return of the inadvertently disclosed information.

Rule 502 limits the circumstances under which inadvertent disclosure of information results in waiver of the attorney-client privilege or work product doctrine and clarifies the scope of subject matter waiver when information is disclosed. The new rule also allows parties to enter into agreements concerning the affect of disclosure in a Federal proceeding and allows a federal court to enter an order finding that, for the purpose of other litigation, disclosure in the proceeding before that court does not result in a waiver. Rule 502 does not change federal or state law on whether information is protected by the attorney-client privilege or work product, rather it modifies the consequences of inadvertent disclosure of documents once it is determined that a privilege exists. Rule 502 also does not relieve an attorney of the obligation to review *potentially* responsive documents to determine whether they are discoverable because they are relevant to the claims and defenses raised or relevant to the subject matter of the action.

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Background

Changes to Federal Rules of Civil Procedure 16 and 26 in December 2006

Fed. R. Civ. P. 16 and Fed. R. Civ. P. 26 were amended in response to the realization that the Federal Rules of Civil Procedure needed updating to meet the complexities of electronic discovery. Rule 16(b) provides procedures to alert the court to the possible need to address the handling of electronically stored information early in the litigation, including scheduling order agreements that the parties reach to facilitate discovery by minimizing the risk of waiver of privilege or work-product protection. Rule 26(f) directs the parties to discuss discovery of ESI if such discovery is contemplated in the litigation. Rule 26(b)(5)(B) provides a procedure for addressing inadvertent disclosure, specifically giving a party the ability to attempt "claw back" of the information which may have been inadvertently disclosed. The rule though does not address whether waiver has actually occurred.

Fed. R. Civ. P. 16(b) and 26(f) act in tandem to allow the parties who enter into quick peek agreements (when a party agrees to produce information for an initial review) and clawback agreements to ask the court to include these agreements in a scheduling order. Hopson v. Mayor of Baltimore, 232 F.R.D. 228, 232 (D. Md. 2005) (if the parties are able to reach an agreement to adopt protocols for asserting privilege and protection which will facilitate discovery that is faster and at a lower cost, they may ask the court to include such arrangements in an order). The problem with any order trying to preserve privilege or protection under these rules was that a court in a subsequent case could find waiver regardless of the terms of the order. As described in further detail below, these agreements continue to present additional problems even under Rule 502.

Inadvertent Disclosure Concerns

The drafters of new Rule 502 concluded that, under the prior rules, if a party inadvertently produced material there was a risk that a court would find a waiver, not only with respect to material that was inadvertently produced, but also all other material touching upon the same subject. As a result of this risk, lawyers spent significant amounts of time and money in complex litigation reviewing documents and electronic material for production to ensure that nothing protected from disclosure was inadvertently produced. Also of concern was the widespread perception that the costs associated with that type of review had risen dramatically in recent years because of the exponential growth in volume of electronically stored information subject to discovery.

Standards for Waiver pre Rule 502

The standards for waiver of the attorney-client privilege and waiver of the work product doctrine are different. Voluntary disclosure to a third party is inconsistent with maintaining confidentiality and waives the attorney-client privilege. In re Qwest Communications Intern. Inc., 450 F.3d 1179 (10th Cir. 2006); In re Columbia/HCA Healthcare Corp. Billing Practices, 293 F.3d 289 (6th Cir. 2002) (voluntary waiver despite previous confidentiality agreement with the Department of Justice); United States v. Workman, 138 F.3d 1261, 1263 (8th Cir.1998); In re Sealed Case, 116 F.3d 550 (D.C. Cir. 1997); First Heights Bank v. United States, 46 Fed. Cl. 312, 316 (2000).

While the mere showing of a voluntary disclosure to a third person will generally suffice to show waiver of the attorney-client privilege, voluntary disclosure alone might not suffice to waive work product protection. Permian v. United States, 665 F.2d 1214, 1219 (D.C. Cir. 1981). That is, voluntary disclosure to third parties does not automatically waive work product. In re Sealed Case, 676 F.2d 793, 809 (D.C. Cir. 1982). Waiver of work product protection occurs only when a disclosure enables an adversary to gain access to the information or the disclosure substantially increases the likelihood that an adversary will come into possession of the material. See Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d 1414, 1428 (3d Cir. 1991); Ferko v. National Ass'n for Stock Car Auto Racing, Inc., 219 F.R.D. 396, 400-01 (E.D. Tex.2003); In re Convergent Technologies, 122 F.R.D. 555, 564 (N.D. Cal.1988); Anderson v. Torrington Co., 120 F.R.D. 82, 86-87 (N.D. Ind.1987).

Prior to the enactment of Rule 502, there was neither Supreme Court precedent nor consensus among jurisdictions about whether inadvertent disclosure waived the attorney-client privilege. Federal courts generally took one of three different approaches as to whether an inadvertent disclosure of an attorney-client privileged communication constitutes a waiver of the privilege: the lenient approach, the strict approach, or a balancing middle of the road approach. Amgen Inc. v. Hoechst Marion Roussel, Inc., 190 F.R.D. 287, 290-92 (D. Mass. 2000).

Under the lenient approach, the privilege holder must have subjectively intended to waive the privilege. Producing a document through mere negligence cannot effect a waiver. See, e.g., Kansas-Nebraska Nat'l Gas Co. v. Marathon Oil Co., 109 F.R.D. 12, 21 (D. Neb. 1985); Mendenhall v. Barber-Greene Co., 531 F.Supp. 951, 954-55 (N.D. Ill. 1982). At the opposite end of the spectrum, the strict approach waives the privilege regardless of the privilege holder's intent. See, e.g., In re Sealed Case, 877 F.2d 976, 979-80 (D.C. Cir. 1989). That is, any document produced, whether knowingly or inadvertently, loses its attorney-client privilege status. This approach created incentives for careful document management during discovery. The third approach, the middle test, required courts to consider the circumstances under which the inadvertent production of a privileged document occurred. See, e.g., Alldread v. City of Grenada, 988 F.2d 1425, 1434 (5th Cir. 1993); Hydraflow, Inc. v. Enidine Inc., 145 F.R.D. 626, 637 (W.D.N.Y. 1993). The middle test analyzes whether the client and lawyer took reasonable precautions to prevent disclosure. The courts then balance the client's obligation to safeguard confidential documents against the simple fact that mistakes are made in large-scale litigation and privileged documents are sometimes inadvertently produced. Gray v. Bicknell, 86 F.3d 1472 (8th Cir. 1996). In general, when there has been an inadvertent disclosure, the analysis for waiver of the work product doctrine is similar to the analysis for waiver of attorney-client privilege. Carter v. Gibbs, 909 F.2d 1450 (Fed.Cir.1990).

Courts have found that waiver of the privilege in an attorney-client communication extends to all other communications relating to the same subject matter regardless of whether the disclosure is inadvertent. In re Sealed Case, 877 F.2d at 980-981. Courts differ, however, as to the scope of the subject matter that would be subject to the waiver. For example, certain courts have held that publication of privileged communications on a tax return waives not only the disclosed communication, but the underlying details regarding the subject matter of that communication as well if those details were in some way incorporated in the return. United States v. Cote, 456 F.2d 142 (8th Cir. 1972); United States v. Schlegel, 313 F.Supp.177 (D. Neb. 1970). Other courts have held that the waiver applies to all the underlying information, including drafts prepared and attorney notes. United States v. (Under Seal), 748 F.2d 871 (4th Cir. 1984).

As applied by the courts, the broad concepts and scope of subject matter waiver analogous to those applicable to claims of attorney-client privilege are different from the scope of subject matter waiver for work product. Some courts have found that, while subject matter waiver applies to fact work product, subject matter waiver does not apply to opinion work product. In re Martin Marietta Corp., 856 F.2d 619, 625-626 (4th Cir. 1988). Other courts have found that the concept of subject matter waiver does not apply at all to work product. Continental Cas. Co. v. Under Armour, Inc., 537 F.Supp.2d 761, 773 (D. Md. 2008) (when work product protection has been waived, it is limited to the information actually disclosed and there is no subject matter waiver); In re United Mine Workers of America Employee Benefit Plans Litig., 159 F.R.D. 307, 310-12 (D.D.C. 1994) (production of documents protected by work product doctrine resulted in waiver of privilege only as to those documents produced).

Fed. R. Evid. 502

Rule 502 covers waivers as a result of voluntary or inadvertent disclosure. It does not purport to deal comprehensively with either attorney-client privilege or work product protection or cover all issues concerning waiver or forfeiture of either. The rule also does not affect other common law waiver doctrines, such as waiver by implication, which occurs when the party asserting the privilege places protected information in issue for personal benefit through some affirmative act, and the court finds that to allow the privilege to protect against disclosure of that information is unfair to the opposing party. In re Keeper of Records, 348 F.3d 16 (1st Cir. 2003).

Rule 502(a)

Rule 502(a) addresses the issue of subject matter waiver when there has been an intentional disclosure made during a federal proceeding or to a Federal office or agency. It applies only to the information disclosed, unless a broader waiver is made necessary by the holder's intentional and misleading use of privileged or protected communications or information. Subsection (a) provides that, when a party produces one privileged document, any resulting waiver of the privilege would not extend to other related documents, so long as there was no intentional and misleading use of protected or privileged information. If a party intentionally places protected information into the litigation in a selective, misleading and unfair manner, then there will be a waiver as to the undisclosed information concerning the same subject matter. Under subsection (a), the waiver extends to an undisclosed communication or information in a Federal or State proceeding only if: (1) the waiver is intentional; (2) the disclosed and undisclosed communications or information concern the same subject matter; and (3) they ought in fairness to be considered together. Subsection (a) clarifies existing law and rejects the position taken by some courts that inadvertent disclosure of protected material can constitute a general subject matter waiver as to other documents or information. This subsection also provides that the federal rule on subject matter waiver governs subsequent state court determinations concerning the scope of the waiver.

Fed. R. Evid. 502 (b)

Rule 502(b) in general codifies the majority rule of the federal courts regarding whether the test to determine if an inadvertent disclosure operates as a waiver of attorney-client privilege or work product. Specifically, the rule provides that disclosure of privileged materials is not a waiver of the privilege if: (1) disclosure is inadvertent; (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and (3) the holder took reasonable steps to rectify the error, including following Fed. R. Civ. Proc. 26(b)(5)(B) if applicable. Subsection (b) resolves the current split among the courts regarding the consequences of inadvertent disclosure. In general, the rule opts for the middle-of-the-road approach. Subsection (b) literally posits a two-part test that only accounts for the reasonable precautions taken and the promptness of the measures taken to rectify the error. The middle-of-the-road approach adopted by the courts was a multi-part test rather than a two-part one. The Advisory Committee, however, retained other traditional middle-of-the-road factors in its note following the rule, stating that the "rule is flexible enough to accommodate any of those listed factors." The requirement to take reasonable steps to prevent disclosure mandate an appropriate level of review to determine if information is privileged or protected and, as such, appears contrary to the goal of reducing the costs associated with ESI discovery.

The case of Rhoads Industries, Inc. v. Building Materials Corp. of America, 254 F.R.D. 216 (E.D. Penn. 2008), illustrates relevant factors that a court may look to when determining whether an inadvertent disclosure amounts to a waiver under Rule 502(b).

In Rhoads Industries, a dispute arose between the parties as to whether plaintiff's inadvertent disclosure of over eight hundred electronic documents amounted to a waiver of privilege with respect to those documents. Upon receiving notice of the inadvertent production, defendants segregated the documents, provided them to the court for *in camera* review, and then the parties agreed that the documents could be returned to plaintiff for logging on a privilege log for further review. Defendants claimed that the privilege relating to these documents was waived by the production of them.

The Rhoads Industries court employed a five factor balancing test under Rule 502(b) to determine if the privilege had been waived. The five factors are: (1) the reasonableness of the precautions taken to prevent inadvertent disclosure in view of the extent of the document production; (2) the number of inadvertent disclosures; (3) the extent of the disclosure; (4) any delay and measure taken to rectify the disclosure; and (5) whether the overriding interests of justice would or would not be served by relieving the party of its errors.

The court found that, when weighing the evidence, the first four factors favored the defendants. The most significant factor was that the plaintiff failed to prepare the segregation and review of privileged documents sufficiently far in advance of the inevitable production of a large volume of documents. The court noted that, once the lawsuit seeking millions of dollars in damages was filed, the plaintiff was under an obligation to invest resources in managing potentially responsive documents.

The court also found that the fifth factor, the interest of justice, strongly favored the plaintiff. The court weighed the loss of the attorney-client privilege against the defendants' need for the information, and determined that the defendants would not be prejudiced by the withholding of the privileged information. Therefore, although four out of the five factors were decided in defendants' favor, the court held that the inadvertent disclosures in this case did not amount to a waiver of the attorney-client privilege.

Rule. 502 (c) and (f)

Rule 502(c) and (f) deal with federal-state comity. If there is a disclosure in a state proceeding, then admissibility in any subsequent federal proceeding will be determined by the law that is most protective against waiver. Rule 502 does not, however, apply to any disclosure made in a state proceeding that is later introduced in a subsequent state proceeding. Subsections (c) and (f) may eventually raise Constitutional questions to the extent they overrule the holding of Erie Railroad Co. v. Tomkins, 304 U.S. 64 (1938), by encroaching on substantive privilege law that has traditionally been left to the states.

Rule 502 (d)

Rule 502(d) allows a federal court to enter an order finding that a disclosure of privileged or protected information does not constitute a waiver. That order will be enforceable against persons in federal or state proceedings and third parties.

Under one possible scenario, the producing party's attorney may choose to intentionally produce an array of documents without reviewing them, knowing with near certainty that they will contain some privileged documents, but relying on the Rule 502(d) order to protect against waiver. Under this scenario, the receiving party would bear the burden of the initial review of the documents by identifying potentially privileged documents and giving notice to the producing party that the produced documents contained privileged or protected information. The receiving party would then decide whether to refrain from reviewing and using the documents.

Rule 502 (e)

Rule 502(e) provides that the parties can enter into an agreement concerning the effect of disclosure in a Federal proceeding, but that agreement will only be binding on the parties to the agreement, unless it is incorporated into a court order pursuant to subsection (d).

Discussion

While Rule 502 is designed to deal with discovery when vast amounts of documents are transmitted and stored electronically, it also applies to those requests seeking only a handful of paper documents. Agreements, such as claw-back agreements (agreements regarding the disposition of inadvertently produced documents) and quick-peek agreements (agreements allowing the requesting party take a quick peek at documents without the producing party undertaking the time and expense in advance to review the entire population of documents), should be avoided.

Generally, under a claw-back agreement, the producing party reviews the documents for privileged or protected information, but the parties agree to a procedure for the return of privileged or protected information that is inadvertently produced. Conversely, when a quick-peek agreement is used, the parties agree that the requesting party will be allowed a pre-production opportunity to inspect the producing party's information, including certain information that may be subject to a claim of privilege. The requesting party then provides the producing party with a request to produce potentially relevant information, which may include the information viewed during the pre-production inspection, and the producing party excises any privileged information from the information determined to be relevant by the requesting party. As a result, the use of quick-peek agreements is inconsistent with the producing party's duty to take reasonable steps to prevent disclosure of privileged or protected information. After the requesting party identifies the documents to be produced, there is still the possibility that a privilege or work product fight will ensue.

There is a concern that these types of agreements will be sought even when documents are not privileged or protected in the first instance. If the information is not privileged or protected, the Service is entitled to receive this information without an agreement. The proper process for obtaining information from the taxpayer is to request the information and then require the taxpayer to prove that it is privileged or protected.

The liberal use of these types of agreements, without first establishing that the documents are privileged or protected, may give taxpayers the impression that they are entitled to these agreements and that the government must negotiate an appropriate agreement before a taxpayer must turn over the responsive documents. Taxpayers may use the negotiation of an agreement as basis for dilatory behavior and simply not turn over responsive information until an agreement to their satisfaction has been entered into.

Entering into such agreements at the audit stage also presents problems. If a revenue agent enters into such an agreement with a taxpayer, that agreement may be binding on Counsel or the Department of Justice should the matter go to litigation.

Rule 502(e) provides that the parties can enter into an agreement concerning the effect of disclosure in a Federal proceeding, but that agreement will only be binding on the parties to the agreement, unless it is incorporated into a court order pursuant to subsection (d). Any agreement at the audit stage that provides that disclosure does not constitute a waiver would not protect against a waiver claim in subsequent litigation by a third party unless the previous audit resulted in litigation and the court entered an order adopting the agreement between the original parties.

Entering into a non-waiver agreement with a view to adoption by the court might be viewed as the Service taking a partisan position in pending or prospective litigation between private litigants for expediency's sake. For example, it may be argued that the entry of a Rule 502(d) order raises a question of whether that order violates the Due Process rights of persons and entities who are not parties to the Tax Court litigation because the rule purports to make an order of the court binding on all persons and entities in all federal or state proceedings, whether or not they were parties to the litigation and regardless of whether the nonparties are subject to the jurisdiction of the Tax Court.

The Advisory Committee notes provide that the rule is limited to the attorney-client privilege and work product protection. The rule does not apply to any governmental privilege, including the deliberative process privilege. The rule also does not apply to the privilege available under I.R.C. § 7525.

Prior agreements, such as the Agreement with Respect to Disclosure in Compliance with Announcement 2002-2, have become superfluous. Those agreements provided that, if the taxpayer produced certain documents, the Service would not assert a subject matter waiver of the attorney-client privilege or the work product doctrine with respect to other documents addressing the same subject matters as those discussed in the listed documents. Rule 502 (a) renders these agreements moot by providing that, when a party produces a privileged or protected document, any resulting waiver of the privilege would not extend to other related documents, so long as there was no intentional and misleading use of protected or privileged information.

Given the concerns and uncertainties regarding the application of Rule 502, as well as the potential impact on the Service's operations and federal tax litigation, any agreement regarding privilege claims and waivers of privilege or the application of Rule 502 must be pre-approved by the Associate Chief Counsel (Procedure & Administration).

Questions regarding Fed. R. Evid. 502 should be directed to Peter Reilly at 202-622-7071.

_______***/s/***__________
Deborah A. Butler
Associate Chief Counsel
(Procedure & Administration)

Attachment

Fed. R. Evid. 502, entitled Attorney-Client Privilege and Work-Product Doctrine; Limitations on Waiver, reads as follows:

(a) DISCLOSURE MADE IN A FEDERAL PROCEEDING OR TO A FEDERAL OFFICE OR AGENCY; SCOPE OF A WAIVER.—When the disclosure is made in a Federal proceeding or to a Federal office or agency and waives the attorney-client privilege or work-product protection, the waiver extends to an undisclosed communication or information in a Federal or State proceeding only if:

(1) the waiver is intentional;
(2) the disclosed and undisclosed communications or information concern the same subject matter; and
(3) they ought in fairness to be considered together.

(b) INADVERTENT DISCLOSURE.—When made in a Federal proceeding or to a Federal office or agency, the disclosure does not operate as a waiver in a Federal or State proceeding if:

(1) the disclosure is inadvertent;
(2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and
(3) the holder promptly took reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26(b)(5)(B).

(c) DISCLOSURE MADE IN A STATE PROCEEDING.—When the disclosure is made in a State proceeding and is not the subject of a State-court order concerning waiver, the disclosure does not operate as a waiver in a Federal proceeding if the disclosure:

(1) would not be a waiver under this rule if it had been made in a Federal proceeding; or
(2) is not a waiver under the law of the State where the disclosure occurred.

(d) CONTROLLING EFFECT OF A COURT ORDER.—A Federal court may order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court—in which event the disclosure is also not a waiver in any other Federal or State proceeding.

(e) CONTROLLING EFFECT OF A PARTY AGREEMENT.—An agreement on the effect of disclosure in a Federal proceeding is binding only on the parties to the agreement, unless it is incorporated into a court order.

(f) CONTROLLING EFFECT OF THIS RULE.—Notwithstanding Rules 101 and 1101, this rule applies to State proceedings and to Federal court-annexed and Federal court-mandated arbitration proceedings, in the circumstances set out in the rule. And notwithstanding Rule 501, this rule applies even if State law provides the rule of decision.

(g) DEFINITIONS.—In this rule:

(1) “attorney-client privilege” means the protection that applicable law provides for confidential attorney-client communications; and
(2) “work-product protection” means the protection that applicable law provides for tangible material (or its intangible equivalent) prepared in anticipation of litigation or for trial.

APPENDIX B

Auditor's Letters: Special Considerations for Employee Benefits Counsel

Pension, Profit-Sharing, Welfare, and Other Compensation Plans

American Law Institute
Annual Advanced Course of Study and Live Video Webcast

October 17-19, 2012
Washington, DC
Washington Plaza Hotel

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Auditor's Letters: Special Considerations for Employee Benefits Counsel

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Auditor's Letters: Special Considerations for Employee Benefits Counsel

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I sometimes cringe when I receive an "auditor's letter" from a client – that is, a letter in which the client directs our firm to provide information to the client's outside auditor. The client, of course, did not write the letter. The auditor did. In fact, although signed by the client, the letter may have arrived in an envelope bearing the auditor's logo. The auditor, of course, needs information to do its job properly. The reality is that (a) the auditor will have required the client to send the letter, (b) the client may not feel that it has much room to negotiate with the auditor over the letter's contents, and (c) the client may not pay much attention to what the letter requests and probably will not understand the potential risks to it in having its attorneys respond. In this commentary, I will share some thoughts on how employee benefits counsel might think through some of the more difficult auditor's letter issues peculiar to the benefits practice.

Let me set the table by simply describing some of the more common and vexing issues for benefits counsel. I will then try to offer, if not a framework, at least some guiding principles for counsel to bear in mind when determining how to respond.

Dilemma One: Fiduciary Breaches, Prohibited Transactions, or Other Violations of Law Not Specifically Identified. Imagine receiving a letter from a client that includes the following:

> We have represented to [our auditor] that there are no unasserted possible claims that you have advised us are probable of assertion and must be disclosed, in accordance with Statement of Financial Accounting Standards No. 5.
>
> We have also represented to [our auditor] that none of the following events have occurred during the years ended as stated above for any of the Plans [identified earlier in this letter]:
>
> - Breach of fiduciary responsibilities
> - Non-exempt party in interest transactions or other transactions prohibited by ERISA
> - Loans or leases in default and reportable to the DOL
> - Events reportable to the PBGC
> - Events that may jeopardize the Plans' tax qualification status
> - Legal actions brought by the Plans on behalf of Plan participants and beneficiaries

- Review or inquiry by the DOL, the IRS, or other regulatory agency of the Plans' activities or filings since the last audits.

Please furnish to [our auditor] such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters as to which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5. For [the client] these items include, but are not limited to, (a) breach of fiduciary responsibilities, (b) party-in-interest transactions prohibited by ERISA, (c) loans or leases in default and reportable to the Department of Labor, (d) events reportable to the Pension Benefit Guaranty Corporation, (e) events that may jeopardize the plan's tax qualification status, (f) legal actions brought by the plan on behalf of the plan participants and beneficiaries, and (g) review or inquiry by the Department of Labor, Internal Revenue Service, or other regulatory agency of the plans' activities or filings since the last audit, for example, a review or inquiry arising from enforcement activities, from a request for an advisory opinion, or from a request for a prohibited transaction exemption. Please specifically confirm to our auditor that our understanding is correct.

Notes About the Language Above:

1. The first paragraph above is consistent with model language found in AICPA Standard of Fieldwork AU Sections 9337.3.07 and 9337.5.13.

   <u>Note on References to AICPA Standards of Fieldwork, AU Sections, and SAS 12</u>: AU Sections 337, 337A, and 337B comprise the text of AICPA Statement on Auditing Standards No. 12 (January 1996) ("**SAS 12**"). SAS 12 was incorporated into the AICPA's "Standards of Fieldwork" in March 1977 as AU Sections 337, 337A, and 337B. I will sometimes refer in this commentary to an AICPA Standards of Fieldwork section simply as "**AU Section ___**." Generally, these references will be to AU Section 337 ("Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments") or AU Section 9337 (Interpretations of Section 337).

2. The third paragraph is model language from AICPA Standard of Fieldwork AU 337A.01. In the model language, this sentence is intended to follow a description by management of unasserted claims and assessments it considers probable of assertion, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome, and where that list includes the following: (1) the nature of the matter, (2) how management intends to respond to the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

3. The first and last sentences of the final paragraph above come from model language set forth in AICPA Standard of Fieldwork AU 337A.01, and are consistent with model language in AU 9337.5.13.

Imagine that the letter also includes the following:

> Please confirm that all information brought to your attention indicating the occurrence of a possibly illegal act committed by [the client], or any of its agents or employees, has been reported to [the auditor] and to the [client's managing body].

How do you respond? Do you rack your brain and scour your files, in an effort to disclose to the auditor all possible violations of law relating to any benefit plan? Does the letter really even ask you to disclose legal violations, or does it instead only ask you to confirm your role in advising the client in connection with FAS 5? And what about the language in the last paragraph listing certain ERISA violations. Is that a suggestion that all such items require disclosure under FAS standards? If not, what is it intended to add to the earlier portions of the paragraph?

If you are being asked to disclose legal violations not specifically identified in the letter, such as seems clearly to be the case in the additional quoted language about possible illegal acts, do you disclose only violations you consider to be serious by some measure? Do you simply refuse to answer? If so, do you tell the auditor that you have been asked to disclose information and are not willing to do so? Do you instead tell only the client that you will not respond, and write nothing to the auditor on the topic. If so, what would you tell the client about why you are unwilling to follow its direction?

Dilemma Two: Unasserted Claims and Qualified Plan Defects. A client writes to direct that you write to its auditor to disclose all unasserted possible claims, without specifically identifying any particular potential claim. Do you disclose the qualified plan defects that you have recently discussed with your client? If so, do you address the client's intentions concerning the possible use of EPCRS to remedy those defects? What, if anything, do you say about the likely outcome of any EPCRS application, and the potential harm to the client from the defects?

What if the client directs you to write to the auditor about a particular VCP application the client specifically identifies in its letter to you, as opposed to instructing you to disclose to the auditor unspecified unasserted claims? Does your approach change?

Dilemma Three: Outcome of Pending Litigation. A client instructs you to write to its auditor to describe all pending or threatened litigation, and to assess the possible outcome, in this way:

> Please furnish to [our auditor] details relating to all matters of pending or threatened litigation with respect to which your firm has devoted substantive attention on our behalf which meet the standard of materiality stated above, including (1) a description of the nature of each matter, (2) the progress of each matter to date, (3) how the Company has responded or intends to respond (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss. Your response should include matters your firm was handling at [*insert financial statement date*] as well as new engagements undertaken during the period from that date to the date of your response.
>
> **Note**: This language is similar to model language set forth in AU Sections 9337.05.11 and .12.

Assume there is pending employee benefits litigation. How, if at all, do you characterize the potential effect of that litigation on the client (that is, the likelihood of an unfavorable outcome and an estimate of the amount or range of potential loss)?

Dilemma Four: The Friendly Call from the Auditor. Auditors feel more pressure than ever to have you "update" your earlier letter. They want to know whether that earlier letter is still accurate and complete. Many auditors, presumably in an effort to gain a quick response, will call for an oral update. How should you respond? While you are on the line, the auditor may also wish to speak in further detail about a particular issue, and perhaps seek your analysis of whether the matter must be disclosed in the client's financial statements.

Responding: Remember the Touchstones. The following should be your goals in responding to a client's letter directing you to provide information to the client's auditor:

1. **Don't Destroy Privilege**. Do not cause information that enjoys attorney-client privilege to lose that privilege by reason of your response. Further, do not disclose information unless the client gives informed consent within the meaning of Rule 1.6(a) of the Model Rules of Professional Conduct (the "**Model Rules**"). These goals may be inherently in tension with the client's request that you disclose information to its auditor.

2. **Be Truthful**. This is always a good goal. And note that Model Rule 4.1 prohibits an attorney, in the course of representing a client, from knowingly making a false

statement of material fact (or law) to a third person, or failing to disclose a material fact to a third person when disclosure is necessary to avoid assisting a fraudulent (or criminal) act by a client, unless disclosure is prohibited under the general confidentiality obligation of Model Rule 1.6.

3. **<u>Don't Prevent the Audit from Being Issued or Cause it to be Qualified</u>**. You want to respond in a way that does not cause the auditor to (a) refuse to issue the audit, or (b) issue a limitation on the scope of the audit.

<u>Privilege</u>. Despite the "fiduciary exception" to attorney-client privilege (see *Washington-Baltimore Newspaper Guild, Local 35 v. Washington Star Co*., 543 F.Supp 906, 3 EBC 1741 (D.D.C. 1992), and its progeny) most clients enjoy privilege with respect to at least some communication with their employee benefits counsel. This may include, for example, advice concerning "settlor" (as opposed to "fiduciary" or "plan administration") issues. *See,* e.g., *In re Unisys Corp. Retiree Medical Benefits ERISA Litigation*, 1994 WL 6883 (E.D. Pa. 1994) (employer's communication with counsel would be privileged to the extent it related to decision to amend or terminate employee benefit plan); *In re Long Island Lighting Co*., 129 F.3d 268 (2d Cir. 1997) (fiduciary enjoyed privilege with respect to communications concerning nonfiduciary matters, even though other communications with the same attorney relating to plan administration may not have been privileged). Even as to communications subject to the fiduciary exception, one might argue that privilege is lost only vis-à-vis participants (and those looking out for their interests, such as the Department of Labor), and perhaps not as concerns others seeking to discover confidential communications.

For a communication to be privileged it must have been made in confidence. For this reason, privilege is lost when confidential information is disclosed to a third party enjoying no privilege, and in fact never arises where a third party not enjoying privilege is present during the ostensibly privileged conversation. *See, e.g., Lewis v. Unum Corp. Severance Plan*, 203 FRD 615 (D. Kan. 2001) (employer waived privilege with respect to communications between in-house counsel and a human resources representative by sending otherwise privileged documents to the plan administrator, a nonprivileged third party fiduciary). The idea is that the disclosure of information to a third-party is inconsistent with the notion that the matter is confidential.

There is reason to fear that the disclosure of otherwise privileged information in an attorney's letter to a client's auditor will cause the loss of privilege. *See, e.g., Gutter v. E.I. Dupont de Nemours & Co.*, 1998 WL 2017926 at *3 (S.D. Fla. 1998) (disclosure to outside accountants waives the attorney-client privilege); *In re Pfizer Inc. Securities Litigation*, 1993 WL 561125, at *6 (S.D.N.Y. 1993) (disclosure of documents to outside accountant destroys the confidentiality required of communications protected by the attorney-client privilege, notwithstanding that the federal securities laws require an independent audit); *Independent Petrochemical Corp. v. Aetna Casualty & Surety Co.*, 117 FRD 292 (D.D.C. 1987); *U.S. v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982) (permitting discovery of attorneys' audit response in connection with IRS administrative subpoena); *U.S. v. Gulf Oil Corp.*, 760 F.2d 292 (Em. App. 1985) (involving Department of Energy subpoena for responses to auditors evaluating impact of previous litigation).

But see, *Tronitech, Inc. v. NCR Corp*., 108 FRD 655 (S.D. Ind. 1985); *In re Honeywell Int'l, Inc. Securities Litigation*, 2003 WL 22722961 (S.D.N.Y. 2003); *U.S. v. Arthur Young & Co.*, 1 Fed. R. Serv. 3d 448 (N.D. Okla. 1984).

The loss of attorney-client privilege by reason of disclosure to an auditor seems the likely result except in those states with a statute recognizing an accountant-client privilege. According to one survey, as of 2004 only 15 states had a statute recognizing accountant-client privilege, and of those, only seven had expressly extended this privilege to independent auditors. *See*, *Brodsky et al,* "The Auditor's Need For Its Client's Detailed Information v. The Client's Need to Preserve the Attorney-Client Privilege and Work Product Protection: The Debate, The Problems, and Proposed Solutions," prepared by attorneys at Latham & Watkins LLP, on behalf of The Corporate Counsel Consortium, Appendix C n. 84.

The American Bar Association's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (approved December 8, 1975) (the "**<u>ABA Statement</u>**") suggests that disclosure to a third party of attorney-client communication on a particular subject may not only destroy privilege as to that communication, but may also destroy privilege as to other communications on that subject. Preamble, ABA Statement. The ABA Statement, together with the American Institute of Certified Public Accountants' Statement on Auditing Standards titled "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments" ("**SAS 12**"), which coordinated auditing practice with the ABA Statement, are sometimes referred to jointly as the "**<u>Treaty</u>**."

Although the work product privilege is less likely to be lost by reason of simple disclosure to a third party than is attorney-client privilege (*see Castle v. Sangamo Westin, Inc.*, 744 F.2d 1164 (11th Cir. 1984), and Restatement (Third) of the Law Governing Lawyers (2002) Section 91(4)), there is reason to fear that disclosure to a client's auditor may even cause a loss of the work product privilege. *See, e.g., Medinol, Ltd v. Boston Scientific Group*, 214 FRD 113, 115 (S.D.N.Y. 2002) (disclosure of work product to auditors waived the privilege because the client and its outside auditor did not share "common interests" in litigation, and disclosures to the auditor did not, therefore, serve the privacy interests that the work product doctrine was intended to protect). In addition, the letter to the auditor may not itself be protected under the work product privilege. *U.S. v. Gulf Oil Corp.*, 760 F.2d 292, 296-97 (Em. App. 1985) (letters in response to audit inquiries did not qualify for work product protection because they were not created in anticipation of litigation, but rather "created, at [the auditor's] request, in order to allow [the auditor] to prepare financial reports which would satisfy the requirements of the federal securities laws"); *Independent Petrochemical Corp. v. Aetna Casualty & Surety Co.*, 117 FRD 292, 298 (D.D.C. 1987) (work product protection did not apply to letters to auditor because those letters were not prepared to assist the company in litigation, but rather to assist the auditor "in the performance of regular accounting work"). *Compare, In re Pfizer Inc. Securities Litigation*, 1993 WL 561125, at *6 (S.D.N.Y. 1993); *U.S. v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998) (in dicta, observing that the work product doctrine would protect an audit-inquiry response); *In re Honeywell Int'l, Inc. Securities Litigation*, 2003 WL 22722961, at *6 (S.D.N.Y. 2003) (work product protection for audit letters and litigation reports prepared by counsel is proper); *Southern Scrap Material Co. v. Fleming*, 2003 WL 21474516, at *9 (E.D. La. 2003) (audit letters were work product); *Vanguard Savings & Loan Assn. v. Barton Banks*, 1995 U.S. Dist. Lexis 13712, at *11-12 (E.D. Pa. 1995) (letters to auditors regarding litigation, prepared to assist client in reporting loss contingency for a regulatory examination, were work product); *Tronitech, Inc. v. NCR Corp*., 108 FRD 655, 657 (audit letter is not prepared in ordinary course of business, but rather arises only in the event of litigation, and therefore should be protected by work product privilege).

Note, incidentally, that even where a communication is not privileged (for example, due to the fiduciary exception), an attorney has a general obligation not to reveal information relating to representation of the client without the client's informed consent. Model Rule 1.6. In that regard, even if there is no privilege, it may not be in your client's best interest to have a qualified plan audit disclose a qualification defect, particularly if no EPCRS application has been filed, given that the audit will likely be attached to an Annual Report (Form 5500) to be filed with the IRS (and DOL, and maybe PBGC).

<u>Don't Prevent the Audit from Being Issued or Cause it to be Qualified.</u> So, why risk the loss of privilege by making disclosure to the auditor? Say the client specifically asks that you disclose to the auditor a potential breach of fiduciary duty or qualified plan defect that could have a material effect on the client's financial statements. After all, you know the client only directed you to make disclosure at the urging of its auditor. Why not just explain to the client the risk in disclosure and have it send a new letter instructing you to ignore its prior directive?

Well, the answer is a very practical one. The auditor will likely insist that the client make the request, to satisfy auditor's obligations in connection with issuance of the audit. So, if you could just help the client convince the auditor that it doesn't need privileged information, perhaps the client could get its audit and not risk the loss of attorney-client privilege (or the work product privilege). This may not be entirely achievable, but it may well be possible to resolve Dilemmas One and Two above (concerning the disclosure of unspecified fiduciary breaches or prohibited transactions, and unspecified unasserted claims) without disclosing privileged information. Notably, the AICPA's interpretations relating to the relevant auditing standards provide that a client need not allow the auditor to examine documents concerning litigation, claims, and assessments, including correspondence and invoices from attorneys, that are considered by the attorney and the client to be subject to the attorney-client privilege. AU Section 9337.4.08. The AICPA interpretations do, however, provide that the auditor may wish to request confirmation from the client's counsel that the information is subject to privilege and that the information was considered by the attorney in responding to the audit inquiry letter.

The AICPA interpretations of SAS 12 provide that the inclusion of language like the following in the audit inquiry letter from the client to its legal counsel does not result in a limitation on the scope of the audit:

> We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way

> to constitute a waiver of the attorney-client privilege or the attorney work product privilege.

AU Section 9337.9.28. The AICPA interpretations also provide that the inclusion of language like the following by attorneys in their response letters to auditors does not result in a limitation on the scope of the audit:

> The client has advised us that, by making the request set forth in its letter to us, the client does not intend to waive the attorney-client privilege with respect to any information which the client has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work product privilege with respect to any of our files involving the client.

The interpretations go on to note that even if the client does not include the first paragraph above, stating its intent to preserve privilege, the attorney's statement that the client has so advised him or her may be based upon the fact that the client has in fact so advised the attorney, in writing or orally, in other communications or in discussions. AU Section 9337.9.30.

You don't want to send an auditor a misleading letter, both because it's not nice (and the Model Rules of Professional Conduct, in Rule 4.1, prohibit making a false statement of material fact or law to a third person in certain circumstances) and because doing so may give rise to liability for you. But, in some cases it may be entirely proper to say to the auditor that you are not providing certain information. In fact, the ABA Statement strongly suggests that you not disclose certain information. This, of course, is awkward if you have a letter from the client directing you to make disclosure, the auditor knows this, and the client, not you, has the privilege. Although not a common approach, it may well make sense to ask the client to withdraw its earlier letter and send a narrower request for disclosure, after explaining to the client the risk in disclosure. But why wouldn't the auditor insist on a response to the broader inquiry? The answer, as more fully explained below, is that the relevant audit standards may not require that the auditor receive the requested information from the attorney and, in fact, may suggest that the auditor not even inquire as to certain matters. It may, therefore, be possible for the client (with some education from the attorney) to gain agreement from the auditor that the client can send a narrower request to the attorney, without jeopardizing the integrity of the audit or causing the auditor to refuse to issue the audit or issue a qualified opinion.

<u>Back to the Problems at Hand: Dilemma One</u>.

<u>Fiduciary Breaches and Other General Inquiries</u>. This brings us back to Dilemmas One and Two. In the first dilemma, the auditor has asked for (a) any explanation you consider necessary to supplement the information provided by the client (that there are no unasserted possible claims you have advised are probable of assertion and must be disclosed), including an explanation of those matters as to which your views may differ from those stated by the client, and (b) confirmation that all information brought to your

attention indicating the occurrence of a possibly illegal act has been reported to the auditor.

As to unasserted possible claims, unless a particular claim has been specifically identified, the expectation expressed by the ABA and AICPA in the Treaty seems to be that the attorney will not be asked to comment, and the attorney will not do so if asked. This is the case even where the client has failed to disclose unasserted possible claims that you have advised the client should be disclosed (or considered for disclosure). Instead, the assumption is that although you may (as discussed later in this commentary) have an obligation to provide the client with advice concerning disclosure, you would not communicate this advice directly to the auditor. In fact, if the client's letter has not identified and asked the attorney to comment upon a matter that the attorney believes should be disclosed, the attorney may generally have an ethical duty <u>not</u> to disclose this information to the auditor. *See* Annotated Model Rules of Professional Conduct, Rule 1.6. Instead, the lawyer should merely inform the auditor that he or she will advise the client when he believes information should be disclosed. The client then must decide whether to identify for the auditor those additional matters. *See*, also, ABA Statement ¶ 6 and Commentary thereto.

Let's review some broad brush concepts under the Treaty to help understand why the attorney's duty is as just described.

<u>Background</u>. The AICPA component of the Treaty, SAS 12, explains that management, not outside counsel, is the "primary source of information" about litigation, claims, and assessments. SAS 12 ¶ 5. SAS 12, does, however, indicate that the auditor should "request the client's management to send a letter of inquiry to those lawyers with whom they consulted concerning litigation, claims, and assessments," and states that "a letter of audit inquiry to the client's lawyer is the auditor's primary means of obtaining corroboration of the information furnished by management concerning litigation, claims, and assessments." SAS 12 ¶¶ 6 and 8.

<u>Litigation and Unasserted Claims</u>. The ABA portion of the Treaty, the ABA Statement, describes three categories of matters with respect to which it may, in some circumstances, be appropriate for a client to ask its attorney to furnish information to the auditor. These are (1) overtly threatened or pending litigation, (2) a contractually assumed obligation, and (3) an unasserted possible claim or assessment.

<u>Need to Specifically Identify Unasserted Claims</u>. Helpfully, SAS 12 lists the matters that should be covered in a letter of audit inquiry (sent to the client's attorney), and includes the following with respect to unasserted claims and assessments:

> A <u>list prepared by management</u> that describes and evaluates unasserted claims and assessments that management considers to be probable of assertion, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome, with respect to which the lawyer has been engaged and to which he has devoted substantive attention on behalf of the company in the form of legal consultation or representation.

(emphasis added) SAS 12 ¶ 9.c. Although the SAS 12 list of matters to be covered in the client's letter to the attorney is not exclusive (SAS 12 states that the matters covered in the letter should "include, but are not limited to, …"), the ABA component of the Treaty, the ABA Statement, in identifying the circumstances in which it is appropriate for an attorney to furnish information to the auditor concerning unasserted possible claims or assessments lists only those unasserted claims and assessments "which the client has specifically identified and upon which the client has specifically requested … comment to the auditor." ABA Statement ¶ 5(c).

<u>Is the Unasserted Claim Probable of Assertion</u>? Further, the ABA Policy states, with respect to unasserted possible claims or assessments, that

> where there has been no manifestation by a potential claimant of an awareness of and present intention to assert a possible claim or assessment, … the client should request the lawyer to furnish information to the auditor only if the client has determined that it is probable that a possible claim will be asserted, that there is a reasonable possibility that the outcome (assuming such assertion) will be unfavorable, and that the resulting liability would be material to the financial condition of the client.

ABA Statement ¶ 5. This is consistent with Statement of Financial Accounting Standards No. 5 ("**FAS 5**"), which only requires disclosure in financial statements of an unasserted claim or assessment when there has been a manifestation by a potential claimant of an awareness of a possible claim or assessment, or where it is probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. FAS 5 ¶ 10. The ABA Statement goes on to say that "it would not be appropriate … for the lawyer to be requested to furnish information … if it appears that (a) the client has been required to specify unasserted possible claims without regard to the standard [set forth in the immediately preceding sentence], or (b) the client has been required to specify all or substantially all unasserted possible claims in which legal advice may have been obtained, since, in either case, such a request would be in substance a general inquiry and would be inconsistent with the intent of this Statement of Policy."

Although not a formal ABA position, the ABA Business Law Section's Committee on Audit Inquiry Responses (which later became the Subcommittee on Audit Inquiry Reponses of the Business Law Section's Committee on Law and Accounting), which was the committee responsible for the development of the ABA Statement, has been pointed in suggesting not only that an attorney not be asked to make disclosures outside the bounds of that contemplated by the ABA Statement, but that an attorney should not comply with such a request if made. In doing so, the Committee noted that SAS 12 provides that a letter of audit inquiry include:

> (i) a <u>list prepared by management</u> that describes and evaluates unasserted claims and assessments that management considers to be probable of assertion, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome, with respect to which the lawyer has been

> engaged and to which he has devoted substantive attention on behalf of the company in the form of legal consultation or representation;

(emphasis added) The Committee then stated that:

> Under no circumstances will the lawyer be required to communicate with the auditor concerning the existence or non-existence (i.e., negative assurance) of unasserted possible claims other than those matters specified by the client in the audit inquiry letter under (i) above (see Paragraph 5(c) of the ABA Statement).
>
> *Comment*: The lawyer should not comment to the auditor concerning unasserted possible claims which have not been listed by management and should not confirm to the auditor the completeness of management's list or the accuracy of management's advice to the auditor concerning its disclosure of all unasserted possible claims advised as necessary by the lawyer . . . . These matters must be worked out between the lawyers and the client, with due regard by the lawyer to his professional obligations (see Paragraph 6 of the ABA Statement).

Introductory Analysis and Guides to Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information, Committee on Audit Inquiry Responses (the "**First Report**"), Section on "Unasserted Claims or Assessments," ¶ (1).

<u>What to Do Where General Inquiry is Made.</u> Well, this is all well and good. Polite clients should restrict their requests to their attorneys concerning the disclosure of information to auditors to those types of requests contemplated by the ABA Statement, and auditors, who of course write the requests that their clients sign, should draft those requests accordingly. The problem is auditors do not always show such gentility, and clients sign what they are given. So, does the attorney abide by the ABA Statement, and in doing so effectively tell the auditor that he or she will not provide information requested by the client? Typically, that is what happens. But it leaves me ill at ease. After all, the attorney has unabashedly proclaimed, in effect, that he or she will not follow the client's instruction. Not that the client will care. And, in fact, the auditor will accept the caveats, and the audit will be issued. But what if the auditor is sued with respect to its review of the financial statements, and in response turns to the attorney, claiming that the attorney had important information that he or she failed to disclose, in direct disobeisance of the client's instruction? After all, the attorney does not own the attorney-client privilege. The client does, and it instructed the attorney to disclose. In appropriate circumstances, the attorney might argue that it need not disclose by reason of the work product doctrine, which is a protection the attorney can claim in his or her own right. *E.g., Donovan v. Fitzsimmons*, 90 FRD 583, 587, 2 EBC 1393 (N.D. Ill. 1981); *Everett v. USAir Group, Inc.*, 165 FRD 1 (D.D.C. 1995).

<u>Ask for Revised Letter</u>. The more satisfying approach would be to explain to the client why it should withdraw its initial request and substitute one that is consistent with the principles of the Treaty. This ought to be acceptable to the auditor, and the attorney can

then follow his or her client's request precisely and without equivocation. In fact, the ABA Statement assumes that the attorney will need to visit with the client before disclosing any confidence to the auditor, and this would be the natural context in which to explain to the client the dangers of disclosure. The ABA Statement explains this need to consult with the client in the following two principles:

> (a) Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, <u>without further consent, unless</u> such information discloses a confidence or a secret or requires an evaluation of a claim.
>
> (b) In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.

(emphasis added) ABA Statement, ¶¶ 1(a) and (b)

<u>Fee Cost of Full Disclosure</u>. In some cases, there may be a practical observation that will move the client to narrow the scope of its request. Where the request is as broad as asking about all fiduciary breaches, prohibited transactions, qualified plan defects, or more amorphous violations of legal standards, particularly without restricting the request to claims that are probable of assertion, it is worth noting for the client not only the risks in disclosure (including the potential for tempting an auditor to treat more seriously than is warranted a possible violation of a legal standard), but also the need for the attorney to engage in a potentially costly review of its files so as to accurately disclose all violations or defects that may relate to a plan. Depending on the request, this could require the review of many years' files and could lead to disclosure of potential defects in an audit, with the concomitant risk of thereby attracting unwanted scrutiny from government agencies or private litigants. Even if a legal concern is not disclosed in the audit, by footnote or otherwise, if the disclosure is discoverable (which, of course, is the essence of the concern about the disclosure of privileged information), the result could be to arm litigants with potential claims they would not otherwise have had reason to explore.

<u>Client Has Disclosed No Unasserted Possible Claims</u>. Let's return for a moment to the particular language in the letter from the client to the attorney in Dilemma One. Recall that the client stated in its letter that it had represented to its auditor there were no unasserted possible claims that the attorney had advised the client were probable of assertion and must be disclosed in accordance with FAS 5, and asked the attorney to furnish to the client's auditor any explanation the attorney considered necessary to supplement this information, including an explanation of any of those matters as to which the attorney's views differ from those stated by the client. Recall that the expectation of the Treaty was that the client would specifically list any unasserted possible claims that were probable of assertion (and, if asserted, would have at least a reasonable possibility of an unfavorable outcome). In our letter, in contrast, no such unasserted possible claims

have been identified. In a Report of the Subcommittee on Audit Inquiry Responses of the ABA Section of Business Law's Committee on Law and Accounting, dated December 17, 1996 (the "**Fourth Report**"), the Committee responsible for the ABA Statement indicated concern with language in auditor inquiry letters like that in our example. In particular, the report discussed two sample paragraphs of concern, as follows:

> We have represented to our auditors that there have been disclosed by management to them all unasserted possible claims that you have advised are probable of assertion and must be disclosed in accordance with the Statement of Financial Accounting Standards No. 5 in the financial statements currently under examination.
>
> Or:
>
> We have represented to our auditors that there are no unasserted possible claims that you have advised that are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5 in the financial statements currently under examination.

The Fourth Report concludes that it is not entirely clear that a responsive answer to an inquiry letter that employs this particular language would constitute a waiver of the attorney-client privilege, but the Committee nevertheless recommends that the attorney's response state the following:

> Please be advised that pursuant to clauses (b) and (c) of Paragraph 5 of the ABA Statement of Policy and related Commentary referred to in the last paragraph of this letter, it would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the company. We can only furnish information concerning those unasserted possible claims or assessments upon which the company has specifically requested, in writing, that we comment nor can we comment upon the adequacy of the company's listing, if any, of unasserted possible claims or assessments or its assertions concerning the advice, if any, about the need to disclose same.

The Report notes that in its interpretation of SAS 12, the Accounting Standards Board has accepted and approved this recommended language for use in attorneys' response letters. AU Sections 9337.10.31 and .32. That is, the inclusion of this, or similar, language does not result in a limitation on the scope of the audit.

<u>Qualified Plan Defects</u>.

<u>Defect Not Specifically Identified in Letter</u>. Recall that Dilemma Two concerned whether to disclose qualified plan defects, and how decisions to use EPCRS affect that decision. As noted above, the expectation of the Treaty is that an attorney will not be required to disclose unidentified unasserted possible claims or assessments. This suggests that unless the client specifically identifies a claim relating a VCP application or

other qualified plan defect, the attorney should not disclose the application or defect. Some attorneys take the opposite approach, disclosing VCP applications, thinking that by doing so they have "played it safe" by being careful to fully disclose what the client has requested, and when in doubt, erred on the side of over disclosure. But one can easily fashion an argument that in disclosing a confidence or secret where disclosure was not necessary, and certainly where the attorney was not authorized to do so, an attorney has either not acted ethically or has not acted with appropriate professional skill.

This suggests two rules of thumb. First, do not disclose more than the client has requested. In some circumstances, over disclosure may be an especially safe approach, but this is not one of them. Second, if the client has asked that you to disclose all unasserted claims, without identifying particular claims, explain to the client that it should not have to make that request (consistent with SAS 12), and explain the dangers to the client in your offering a full response to the auditor. At that point, the best outcome would be for the client to withdraw its initial request and substitute a request that is consistent with the Treaty.

Disclosure Requested for Specific Defect. Let's say, though, that the client has asked that you provide information to the auditor about a particular qualified plan defect. To the extent providing the requested information would involve the disclosure of a confidence or a secret, or require an evaluation of a claim, the ABA Statement instructs the attorney to make full disclosure to the client of the legal consequences of such disclosure before responding to the auditor. ABA Statement, ¶¶ 1(a) and (b). Otherwise, the client would not have had the information necessary to provide consent to the disclosure. In this regard, if a qualified plan defect has not yet been made the subject of a disclosure to a government agency, such as through a VCP filing, one would typically expect the defect to be a confidence or secret, whether or not the fiduciary exception prevents the client from enjoying attorney-client privilege vis-à-vis participants or the Department of Labor. This suggests that the attorney should counsel the client on the risks of disclosure.

Even where a defect has already been disclosed in a VCP filing, or will be so disclosed prior to any audit being issued or filed with the IRS, DOL, and possibly PBGC (as an attachment to an Annual Report on IRS Form 5500), there is risk in disclosure. In particular, even where the IRS issues a compliance statement in response to the VCP filing, disclosure of the defect could trigger ERISA Title I claims for benefits. That could happen, for example, where as part of a compliance statement a plan were permitted to fail to follow a plan term, to the detriment of participants. If the qualification defect is also a violation of a parallel provision of Title I of ERISA, participants might then file suit to enforce the original plan provision.

Asserted Claims Not in Litigation. The ABA Statement and SAS 12, when discussing disclosure relating to loss contingencies, talk in terms of litigation, claims, and assessments. Interestingly, the ABA Statement, when discussing disclosure with respect to claims and assessments, only talks about "unasserted possible" claims and assessments. ABA Statement, ¶ 5. At first blush, the ABA Statement seems to assume that although an attorney may be asked about overtly threatened or pending litigation, or about unasserted possible claims and assessments, he or she will not be asked about claims that have been asserted but that are not as of yet threatened or pending litigation. Perhaps more accurately, the ABA Statement seems to assume, a bit inexplicably, that the attorney cannot respond with respect to an inquiry about a claim or assessment that has been asserted, unless that claim or assessment has risen to the level of “threatened litigation.” The Commentary to the ABA Statement, which is an integral part of the Statement, reinforces this literal reading when it states that “Paragraph 5 of the Statement of Policy summarizes the categories of ‘loss contingencies’ about which the lawyer may furnish information to the auditor.” Paragraph 5 is where the Statement then lists litigation and unasserted possible claims and assessments, but not asserted claims or assessments (other than those that involve threatened litigation).

This distinction, if indeed intended, is puzzling. What appears at first blush to be a distinction between asserted claims and unasserted possible claims may, however, in reality not be a distinction at all. That is because asserted claims may in fact fall into the category of “overtly threatened litigation.” Specifically, the ABA Statement says that “overtly threatened litigation” means “that a potential claimant has manifested to the client an awareness of and present intention to assert a possible claim or assessment unless the likelihood of litigation (or of settlement when litigation would normally be avoided) is considered remote.” ABA Statement, ¶ 5. The parenthetical may mean that where a claim has been asserted it falls into the “overtly threatened litigation” category even if litigation is not expected, because in that circumstance the matter will be considered to be settled in one fashion or another without resort to litigation.

<u>Propriety of the Request to Disclose Defect: Is the Claim Probable of Assertion</u>? As noted earlier, the ABA Statement indicates that in the case of an unasserted possible claim or assessment, as opposed to overtly threatened or pending litigation, where there has been no manifestation by a potential claimant of an awareness of and present intention to assert a possible claim or assessment, the client should request the lawyer to furnish information to the auditor only if the client has determined that (a) it is probable that a possible claim will be asserted, (b) there is a reasonable possibility that the outcome (assuming such assertion) will be unfavorable, and (c) the resulting liability would be material to the financial condition of the client. ABA Statement ¶ 5. Unless the IRS, or another party, is already aware of a qualified plan defect (which will be the case for only a small percentage of defects, unless a VCP application has been filed or private litigants have indicated such knowledge – perhaps in connection with a claim for violation of a parallel provision of Title I of ERISA), it will normally not be probable that a possible claim will be asserted (unless a VCP application will later be filed).

As noted, the ABA Statement indicates that the attorney should not be asked about an unasserted possible claim unless the client has determined that it is probable of assertion. Similarly, SAS 12 indicates that a letter of audit inquiry to an attorney should include a list prepared by management (of the client) that describes and evaluates unasserted claims and assessments “that management considers to be *probable of assertion*, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome ….” (emphasis added) SAS 12 ¶ 9.c. (Although SAS 12 lists only claims that are probable of assertion, it indicates that its list of matters to be included in the audit inquiry letter is not exclusive ("The matters that should be covered … include, but are not limited to, …."). SAS 12 ¶ 9.) So, where a claim relating to a qualified plan defect is not probable of assertion, as will commonly be the case if no VCP application will be filed, the attorney may wish to explain to the client that SAS 12 suggests that the auditor should not ask the client to make the request, and that disclosure may result in disclosure in the audit (probably in a footnote) that could then trigger scrutiny from the IRS, or from private litigants seeking to enforce a parallel provision of Title I of ERISA.

Meaning of "Probable." There is some tension between the ABA Statement and the relevant accounting standard on what it means for a claim to be "probable" of assertion, or that it is "probable" litigation will result in an unfavorable outcome. Before considering these differences, it may be helpful to review some background concerning when "loss contingencies" must be accrued or otherwise disclosed on financial statements. Statement of Financial Accounting Standards No. 5 ("**FAS 5**") issued by the Financial Accounting Standards Board in March, 1975, defines what constitutes a "loss contingency" that may either need to be accrued by a charge to income, or otherwise disclosed.

A "loss contingency" is an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to a client that will ultimately be resolved when one or more future events occur or fail to occur. FAS 5, ¶ 1. A loss contingency must be accrued if it is both (a) probable that a liability had been incurred at the date of the financial statements, and (b) the amount of loss can be reasonably estimated. A loss contingency that need not be accrued must still be disclosed if (a) there is at least a "reasonable possibility" that a loss may have been incurred, or (b) it is probable that a liability has been incurred, but the amount of the loss cannot be reasonably estimated. FAS 5 ¶¶ 8 and 10, and n.6.

FAS 5 explains that when a loss contingency exists, the likelihood that the future event or events will confirm the loss or the incurrence of a liability can be characterized by one of three terms, ranging from probable to remote. Those three terms are:

(a) *Probable*. The future event or events are likely to occur.
(b) *Reasonably possible*. The chance of the future event or events occurring is more than remote but less than likely.
(c) *Remote*. The chance of the future event or events occurring is slight . . . .

FAS 5 ¶ 3. The ABA Statement restates the meaning of these terms in a way that may make a claim less likely to be considered "probable" and more likely to be considered "remote." It does so in a fashion that makes it rather unlikely that an unasserted claim will be probable of assertion (which means it will be unlikely to be an appropriate matter for the client to ask the attorney to disclose to the auditor). ABA Statement ¶ 5 and Commentary ¶ 5.

The ABA Statement states as follows:

> In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either "probable" or "remote;" for purpose of any such judgment it is appropriate to use the following meanings:
>
> > (i) *probable* – an unfavorable outcome for the client is probable if the prospects of the claimant not succeeding are judged to be extremely doubtful and the prospects for success by the client in its defense are judged to be slight.
> >
> > (ii) *remote* – an unfavorable outcome is remote if the prospects for the client not succeeding in its defense are judged to be extremely doubtful and the prospects of success by the claimant are judged to be slight.
>
> If, in the opinion of the lawyer, considerations within the province of his professional judgment bear on a particular loss contingency to the degree necessary to make an informed judgment, he may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is "probable" or "remote," applying the above meanings. No inference should be drawn, from the absence of such judgment, that the client will not prevail.
>
> The lawyer also may be asked to estimate, in dollar terms, the potential amount of loss or range of loss in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss (if the outcome should be unfavorable) only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight.
>
> The considerations bearing upon the difficulty in estimating loss (or range of loss) where pending litigation is concerned are obviously even more compelling in the case of unasserted possible claims. In most cases, the lawyer will not be able to provide any such estimate to the auditor.

ABA Statement ¶ 5.

The Commentary to the ABA Statement, which is an integral part of the Statement, goes even further in defining "probable" and "remote" in a fashion that, at least arguably, makes it less likely that an outcome will be probable than under the FAS 5 definitions. At least in the context of litigation, the Commentary offers this "amplification" on the meaning of the terms "probable" and "remote":

> [A]s a general rule, it should not be anticipated that meaningful quantifications of "probability" of outcome or amount of damages can be given by lawyers in assessing litigation.
>
> * * * * *
>
> [T]his commentary amplifies the meanings of the terms under discussion, as follows:
>
> *'probable'* – An unfavorable outcome is normally "probable" if, but only if, investigation, preparation (including development of the factual data and legal research) and progress of the matter have reached a stage where a judgment can be made, taking all relevant factor into account which may affect the outcome, that it is extremely doubtful that the client will prevail.
>
> *'remote'* – The prospect for an unfavorable outcome appears, at the time, to be slight; i.e., it is extremely doubtful that the client will not prevail. Normally, this would entail the ability to make an unqualified judgment, taking into account all relevant factors which may affect the outcome, that the client may confidently expect to prevail on a motion for summary judgment on all issues due to the clarity of the facts and the law.

ABA Statement, Commentary ¶ 5.

The Commentary continues its discussion of the terms "probable" and "remote" in this way:

> In other words, for purposes of the lawyer's response to the request to advise auditors about litigation, an unfavorable outcome will be 'probable' only if the chances of the client prevailing appear slight and of the claimant losing appear extremely doubtful; it will be 'remote' when the client's chances of losing appear slight and of not winning appear extremely doubtful. <u>It is, therefore, to be anticipated that, in most situations, an unfavorable outcome will be neither 'probable' nor 'remote'</u> as defined in the Statement of Policy.
>
> <u>The discussion above about the very limited basis for furnishing judgments about the outcome of litigation applies with even more force to a judgment concerning whether or not the assertion of a claim not yet asserted is 'probable.' That judgment will infrequently be one within the professional competence of lawyers and therefore the lawyer should not undertake such assessment except where such judgment may become meaningful because of the presence of special circumstances, such as</u> catastrophes, investigations and previous public disclosure as cited in Paragraph 5 of the Statement of Policy, or similar extrinsic evidence relevant to such assessment. Moreover, it is unlikely, absent relevant

> extrinsic evidence, that the client or anyone else will be in a position to make an informed judgment that assertion of a possible claim is 'probable' as opposed to 'reasonably possible' (in which event disclosure is not required). In light of the legitimate concern that the public interest would not be well served by resolving uncertainties in a way that invites the assertion of claims or otherwise causes unnecessary harm to the client and its stockholders, a decision to treat an unasserted claim as 'probable' of assertion should be based only upon compelling judgment.
>
> Consistent with these limitations believed appropriate for the lawyer, he should not represent to the auditor, nor should any inference from his response be drawn, that the unasserted possible claims identified by the client (as contemplated by Paragraph 5(c) of the Statement of Policy) represent all such claims of which the lawyer may be aware or that he necessarily concurs in his client's determination of which unasserted possible claims warrant specification by the client; within proper limits, this determination is one which the client is entitled to make – and should make – and it would be inconsistent with his professional obligations of the lawyer to volunteer information arising from his confidential relationship with his client.
>
> As indicated in Paragraph 5, the lawyer also may be asked to estimate the potential loss (or range) in the event that an unfavorable outcome is not viewed to be 'remote.' In such a case, the lawyer would provide an estimate only if he believes that the probability of inaccuracy of the estimate of the range or amount is slight. What is meant here is that the estimate of amount of loss presents the same difficulty as assessment of outcome and that the same formulation of 'probability' should be used with respect to the determination of estimated loss amounts as should be used with respect to estimating the outcome of the matter.
>
> In special circumstances, with the proper consent of the client, the lawyer may be better able to provide the auditor with information concerning loss contingencies through conferences where there is opportunity for more detailed discussion and interchange. However, the principles set forth in the Statement of Policy and this Commentary are fully applicable to such conferences.

(emphasis added) ABA Statement, Commentary ¶ 5. Both FAS 5 and the ABA Statement offer these examples of circumstances in which unasserted claims may (depending on the facts, according to the ABA Statement) be probable of assertion:

> [A] catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the

> probability of their assertion and the possibility of loss should be considered in each case.

ABA Statement ¶ 5; FAS 5 ¶ 38.

The Commentary to the ABA Statement lists the same examples, but, with respect to a catastrophe, includes a condition that the client's involvement be "open and notorious." The Commentary includes the following in its list of circumstances in which unasserted claims may be probable of assertion:

> (i) a catastrophe, accident or other similar physical occurrence in which the client's involvement is open and notorious, or (ii) an investigation by a government agency where enforcement proceedings have been instituted or where the likelihood that they will not be instituted is remote, under circumstances where assertion of one or more private claims for redress would normally be expected.

ABA Statement, Commentary ¶ 5.

The ABA Statement also offers this example of an unasserted claim that may be probable of assertion:

> (iii) a public disclosure by the client acknowledging (and thus focusing attention upon) the existence of one or more probable claims arising out of an event or circumstance.

ABA Statement ¶ 5.

As noted earlier, the Commentary to the ABA Statement adds its own explanation concerning the FAS 5 definition of the terms used to characterize the probability of an event. It "amplifies" the meanings of those terms, as follows:

> *'probable'* – An unfavorable outcome is normally "probable" if, but only if, investigation, preparation (including development of the factual data and legal research) and progress of the matter have reached a stage where a judgment can be made, taking all relevant factor into account which may affect the outcome, that it is extremely doubtful that the client will prevail.
>
> *'remote'* – The prospect for an unfavorable outcome appears, at the time, to be slight; i.e., it is extremely doubtful that the client will not prevail. Normally, this would entail the ability to make an unqualified judgment, taking into account all relevant factors which may affect the outcome, that the client may confidently expect to prevail on a motion for summary judgment on all issues due to the clarity of the facts and the law.

ABA Statement, Commentary ¶ 5.

Based on the discussion above, one can argue that the FAS 5 standard and ABA Statement standard for a claim being "probable" of assertion are different. Some commentators have suggested that an outcome is probable within the meaning of the ABA Statement only if there is a 90 or 95 percent likelihood of it occurring, and that an outcome is remote only if there is a 5 or 10 percent likelihood of it occurring. What, then, if an unasserted claim is probable of assertion under the FAS 5 standard, but not under the ABA Statement? In that event, one assumes the auditor would not agree to the client failing to request disclosure from the attorney. So, any request by the attorney that the client withdraw its request for disclosure about a specific claim that the client believes is probable of assertion (under the FAS 5 definition), but the attorney believes is not probable of assertion (under the ABA Statement standard), would probably fail. If after explaining the risks of disclosure, the client nevertheless instructs the attorney to disclose, the ABA Statement, rather remarkably, suggests that the attorney nonetheless need not respond. (The lawyer need not "undertake to furnish information to the auditor concerning loss contingencies except as contemplated by [ABA Statement Paragraph 5, which includes the definitions of "probable" and "remote" discussed above].")

This brings us back to an earlier question: What right does the attorney have to fail to follow his or her client's instruction, absent some work product privilege? I don't have a good answer, which suggests there may be no such right. Perhaps, though, the attorney can argue that by explaining in the letter to the auditor that the attorney's response is being made under the standards of the ABA Statement, the attorney has not engaged in any misrepresentation or otherwise misled the auditor by failing to provide the requested information. Time will tell whether that is a good argument, as auditors more frequently sue lawyers in *pari passu* with the increase in the number of lawsuits in which they are alleged to have failed to properly do their job.

This possibility of suit by auditors (or perhaps those relying on audited financial statements) is the real risk for attorneys in failing to make disclosure to auditors. After all, the client likely won't complain that the attorney failed to fully respond, so long as the audit is issued and is not qualified. The state ethics board probably won't complain, because the attorney will have followed the ABA Statement. It is, however, notable in this regard that the Restatement (Third) of the Law Governing Lawyers (the "**Restatement**") indicates that where a client asks an attorney to undertake an evaluation to present to a third party, and the client consents to the scope of the disclosure, the attorney may give that opinion and, under the circumstances, undertakes a duty to the third party to speak truthfully. Restatement ¶ 95 (2000). *See also* Model Rule 2.3. And as noted earlier, Model Rule 4.1 requires that an attorney not make a false statement of material fact (or law) to a third person, and not fail to disclose a material fact if necessary to avoid assisting a criminal or fraudulent act by a client (unless disclosure is prohibited under Model Rule 1.6). With respect to public companies, there may be additional dangers in failing to fully disclose, as noted in the section below on Sarbanes-Oxley.

But what would be the risk in <u>following</u> the client's instruction to disclose. Perhaps none. The auditor would presumably have no claim against the attorney. One assumes the client would not either, if it gave consent to disclosure after having been properly advised by the attorney of the risks. As to the state ethics board, what complaint could it raise where the attorney followed his or her client's instruction to disclose, after the client had properly waived privilege? This suggests that following the ABA Statement may not only fail to protect the attorney from liability, but may in some circumstances even put the attorney at risk. About the only argument to the contrary that occurs to me is that the client might argue it was harmed by the disclosure, and the attorney had an ethical obligation to the client to ignore its instruction and instead follow the ABA Statement. This seems a hard argument to articulate in sincere tones. In fact, the ABA committee responsible for the development of the ABA Statement issued a report in which it expressed its view that no attorney is obligated to follow the ABA Statement in any event. It stated:

> By way of preface to a discussion of the intended meaning of certain of the essential terms of this provision, the Committee recognizes that the ABA Statement of Policy was developed for the guidance of the legal profession and does not represent a prescription for lawyer conduct. Accordingly, no lawyer is obliged to enter into an understanding with his client conforming to the ABA Statement of Policy, nor is he obliged to confirm to auditors that such an understanding exists. . ..

(footnotes omitted). ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Request for Information, Second Report of the [ABA Business Law Section's] Committee on Auditor Inquiry, Responses Regarding Initial Implementation (August 1976 (the "**Second Report**"), Section on "A Lawyer's Professional Responsibility to His Client with Respect to Matters Recognized to Involve an Unasserted Possible Claim."

Is There a Claim? Recall that the ABA Statement contemplates an attorney providing requested information relating to (a) overtly threatened or pending litigation, (b) an unasserted possible claim or assessment, or (c) a contractually assumed obligation. ABA Statement ¶ 5. Where an attorney is directed to provide information concerning a specified qualified plan defect, and there is reason to believe the defect is of the type that can be resolved through the use of EPCRS without the IRS making any serious threat of plan disqualification, one might wonder whether the need to resolve the matter through EPCRS involves any potential claim or assessment (or overtly threatened litigation). After all, one expects that the IRS will not actually make any claim, but that the matter will instead be resolved through use of EPCRS. Presumably, though, the unasserted potential claim lies in the possibility that the IRS will take the position that the plan is disqualified and make a claim for tax liability, or will seek a material sanction under a closing agreement in lieu of disqualification. Depending on the defect, there may also be the possibility of a claim under Title I of ERISA. Whether either type of claim is probable of assertion is a different question (as discussed above). (Where it appears EPCRS can and will be used, a claim by the IRS would typically seem remote.) An attorney who decides that the client need not disclose under FAS 5 would probably be well advised not to reach this conclusion exclusively on the basis of there being no possible unasserted claim in connection with a qualified plan defect, but instead on the basis that there is no such claim that is probable of assertion.

Government Audits. Much of the analysis concerning Dilemmas One (fiduciary breaches, and so forth) and Two (qualified plan defects) would seem to apply in determining when and how to disclose the existence of an audit by a government agency, such as the IRS, DOL, or PBGC. Under the ABA Statement, an attorney would not disclose such an investigation, absent a specific inquiry about a particular investigation (unless there were overtly threatened litigation). Where the client does instruct the attorney to make disclosure concerning a specific investigation, the attorney should follow the analysis generally applicable to inquiries about specific unasserted potential claims or assessments (unless litigation has been threatened or is pending, in which the attorney should follow the analysis applicable to litigation, discussed below with respect to Dilemma Three).

Although not an official ABA pronouncement, commentary in a report of the ABA committee that was responsible for the ABA Statement includes an interesting discussion concerning disclosure precipitated by an ongoing government investigation. It states as follows:

> In many cases, the lawyer will have been engaged to represent the client in connection with a governmental investigation involving the client, such as a Federal Grand Jury impaneled to investigate possible antitrust violations or an investigation by the staff of the Securities and Exchange Commission concerning possible violations of the Federal securities laws. Where no charges have been made against the client or with respect to its conduct, such situations do not involve overtly threatened litigation, since there has not been manifested to the client an awareness of and present intention to assert a possible claim or assessment as contemplated by Paragraph 5(c) of the ABA Statement of Policy; for that reason, doubt has been expressed whether it is proper for the lawyer to describe the matter to the auditor when the client has not specifically requested comment thereon in the inquiry letter.
>
> The Committee believes that, if the client wishes the lawyer to report such investigations and similar matters to the auditor in a manner similar to reports by the lawyer of pending litigation which the lawyer is handling, it would not be improper for the lawyer to do so since a third-party inquiry (which may develop into the assertion of a claim or assessment) already will have been commenced. <u>In most cases, however, the lawyer will not be able to provide any information to the auditor concerning the investigation other than the existence thereof and the fact of the client's involvement</u>. Consideration of the possible assertion of one or more private claims by reason of the investigation, as suggested by Paragraph 5 of the ABA Statement of Policy, would usually be premature until such time as charges stemming therefrom are actually made against the client. Whichever approach is adopted for a particular client – regularly reporting such matters or only reporting those as to which the client has determined the matter to involve an unasserted possible claim considered to be probable of assertion and to have a reasonably possible

> chance of an adverse result – that approach should be consistently followed with respect to such client until the auditor has been advised of a change in approach.

(emphasis added) Second Report, Section on "Treatment of Pending Investigation Involving a Client When No Charges Against the Client Have Been Overtly Threatened."

Dilemma Three: Outcome of Pending Litigation. Recall that Dilemma Three concerns how to respond to an instruction to disclose information about pending or threatened litigation. The ABA Statement indicates that, unlike in the case of unasserted possible claims, it is proper to follow an instruction to disclose with respect to pending or threatened litigation, whether or not the litigation has been specified by the client. ABA Statement, ¶ 5. As noted above in the discussion captioned "Meaning of 'Probable,'" the ABA Statement does, however, urge caution in expressing judgments as to the outcome of such pending or threatened litigation, except in those "relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either 'probable' or 'remote.'" ABA Statement ¶ 5. This is the juncture where the ABA Statement then offers its own take on what the terms "probable" and "remote" mean, without offering a satisfying explanation of why an attorney is permitted, when following the client's direction to disclose to the auditor, to deviate from the definitions of those terms set forth in FAS 5, the relevant accounting standard for determining loss contingencies.

A report of the ABA committee responsible for the ABA Statement strongly cautioned against labeling an unfavorable outcome as "reasonably possible," which is the intermediate standard under FAS 5 for the likelihood of an outcome. Although the report was not approved by formal action of the entire ABA, it is interesting to note the lack of equivocation in its conclusion:

> The ABA Statement examines considerations bearing upon a determination that an unfavorable outcome is 'probable' or 'remote'; if neither, an unfavorable outcome is, by the process of elimination, 'reasonably possible.' If the lawyer cannot advise that an unfavorable outcome is 'probable' or 'remote,' he should state that he is unable to form such a judgment.

First Report, Section on "Evaluation of Outcome."

As noted earlier in this commentary, in the section on "Meaning of 'Probable,'" the Commentary to the ABA Statement is similarly cautious as concerns any request to assess the amount of potential loss. It states that "as a general rule, it should not be anticipated that meaningful quantifications of 'probability' of outcome *or amount of damages* can be given by lawyers in litigation." (emphasis added) ABA Statement Commentary ¶ 5.

The result of following the ABA Statement will typically be to make a strictly factual disclosure concerning pending litigation (and maybe even less concerning threatened litigation), with the possible addition of an unexceptional and not very illuminating indication that the client intends to vigorously contest the matter. SAS 12 actually assumes, in an Appendix setting forth an "Illustrative Audit Inquiry Letter to Legal Counsel," that <u>management</u> will, in the audit inquiry letter to the attorney, specifically list pending and threatened litigation, and in doing so will include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3), how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss. This list is to be followed by a request that the attorney furnish to the auditor any explanation that the attorney considers necessary to supplement the information listed by the client, including an explanation of those matters as to which the attorney's views may differ from those stated by the client and an identification of the omission of any pending or threatened litigation. The Appendix to SAS 12 also, incidentally, assumes that the client will identify and set forth the same types of information relating to unasserted claims and assessments considered by management to be probable of assertion, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome. In actual practice, though, the letter from the client may not list specific pieces of pending or threatened litigation and, as a result, it may be the attorney, in his or her letter to the auditor, who provides the information in (1), (2), and perhaps (3), above.

<u>Dilemma Four: Request for Oral Update.</u> Because auditors need information that is contemporaneous with the completion of their audit, they sometimes ask for an update of an attorney's prior letter to them. Even if the audit inquiry letter asked that the attorney not respond prior to a particular date (projected to be the approximate date when the auditor would wrap up the audit), issuance of the audit may have been unexpectedly delayed, causing the auditor to seek an update. My advice is to not give oral updates, and say in your original letter that you will not give oral updates. Instead, follow the same process for an update request as you would follow for an initial request.

This is good advice for a couple of reasons. First, remember that you were permitted to respond in your initial letter only because you received a direction from your client to do so, and in doing so may have needed to advise your client on the dangers in disclosing confidences and secrets. The auditor, therefore, is the wrong party to be making the update request. Second, you should require that the client's request to provide an update be in writing, just like its original request. Written requests and written responses reduce the potential for misunderstanding. We all have some tendency to misunderstand what another says, and that is particularly true with respect to oral communications because we (a) only hear the information once (unlike a letter, which can be revisited many times), (b) may be distracted during the conversation, (c) may have some tendency to hear what we want to hear, and (d) are more likely to misunderstand given the inherently less precise and less well constructed prose we use when speaking (as compared with writing). It is important to have a <u>policy</u> requiring that requests for updates come from the client and be in writing. That is because, if necessary, you want to be able to testify that you know you did not give the auditor an oral update saying everything was fine (when, in fact, it wasn't) because you *never* give oral updates. If you have a strict policy against oral updates, your testimony will be much more persuasive than if you testify that you can't really remember oral update request number 763, but you know you wouldn't have said everything was hunky-dory since that was not true.

FAS 5 Obligation. Most benefits attorneys probably do not consider themselves experts on financial statement disclosure. Nevertheless, SAS 12 instructs the auditor to obtain assurance from management, ordinarily in writing, that they have disclosed all unasserted claims that the attorney has advised them are probable of assertion and must be disclosed in accordance with FAS 5. SAS 12 instructs the auditor, with the client's permission, to inform the attorney that the client has given the auditor this assurance. In fact, though, this client representation may be communicated by the client in its inquiry letter to the attorney (which is more typical). Only less often is it communicated by the auditor in a separate letter[1].

SAS 12 also tells the auditor that the letter of audit inquiry to the attorney should include:

> A statement by the client that the client understands that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, the lawyer has formed a professional conclusion that the client should disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.

Consistent with this, most letters from clients directing attorneys to make disclosure to their auditors will include a paragraph substantially similar to this one (which comes from the Appendix to SAS 12):

> We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5. Please specifically confirm to our auditors that our understanding is correct.

[1] SAS 12 gives this example of a separate letter to be signed and sent by the auditor: We are writing to inform you that (name of company) has represented to us that (except as set forth below and excluding any such matters listed in the letter of audit inquiry) there are no unasserted possible claims that you have advised are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5 in its financial statements at (balance sheet date) and for the (period) then ended. (List unasserted possible claims, if any.)

So, does all of this mean that every time an attorney learns of a potential legal violation he or she must consider whether FAS 5 requires financial statement disclosure of the matter and advise the client accordingly? What would be the basis for imposing such an obligation on an attorney if the client has not asked the attorney to perform this function? Well, first of all, note that SAS 12 addresses circumstances where the "lawyer has formed a professional conclusion that the client should disclose or consider disclosure" concerning a possible claim or assessment. What if an attorney has not formed such a conclusion, simply because he or she has not thought about that question or does not feel competent to make that determination (because of a lack of expertise concerning FAS 5)? In this regard, the ABA Statement adds an important, and probably correct, condition to the attorney's obligation. It suggests that this obligation arises only where the attorney has as part of his or professional responsibility an obligation to advise the client concerning the need for or advisability of public disclosure. ABA Statement ¶ 6. Specifically, the ABA Statement states:

> *Lawyer's Professional Responsibility*. Independent of the scope of his response to the auditor's request for information, the lawyer, depending upon the nature of the matters as to which he is engaged, may have as part of his professional responsibility to his client an obligation to advise the client concerning the need for an advisability of public disclosure of a wide range of events and circumstances. The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. The lawyer also may be required under the Code of Professional Responsibility to resign his engagement of his advice concerning disclosures is disregarded by the client. The auditor may properly assume that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, the lawyer has formed a professional conclusion that the client must disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult the client concerning the question of such disclosure and the applicable requirements of FAS 5.[2]

ABA Statement ¶ 6. The Commentary to the ABA Statement (which, remember, is an integral part of the Statement) is even more helpful. It suggests that the obligation arises only where the attorney's "engagement is to advise his client concerning a disclosure obligation." More generally the Commentary states:

> The client must satisfy whatever duties it has relative to timely disclosure, including appropriate disclosure concerning material loss contingencies, and, to the extent such matters are given substantive attention in the form

[2] Under FAS 5, when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, disclosure of an unasserted possible claim is required only if the enterprise concludes that (i) it is probable that a claim will be asserted, (ii) there is a reasonable possibility, if the claim is in fact asserted, that the outcome will be unfavorable, and (iii) the liability resulting from such unfavorable outcome would be material to its financial condition.

> of legal consultation, the lawyer, when his engagement is to advise his client concerning a disclosure obligation, has a responsibility to advise his client concerning its obligations in this regard. Although lawyers who normally confine themselves to a legal specialty such as tax, antitrust, patent or admiralty law, unlike lawyers consulted about SEC or general corporate matters, would not be expected to advise generally concerning the client's disclosure obligations in respect of a matter on which the lawyer is working, the legal specialist should counsel his client with respect to the client's obligations under FAS 5 to the extent contemplated herein. Without regard to legal specialty, the lawyer should be mindful of his professional responsibility to the client described in Paragraph 6 of the Statement of Policy concerning disclosure.

ABA Statement, Commentary ¶ 6. Unfortunately, the "illustrative form of letter" offered for use by attorneys in providing disclosure to auditors, found in Annex A to the ABA Statement, does not include this qualification concerning whether the attorney has been engaged to provide advice on financial statement disclosure. The relevant language in that illustrative letter is as follows:

> Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy, this will confirm as correct the Company's understanding that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, I, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.

Although not formal ABA pronouncements, a couple of reports issued by the ABA committee responsible for the ABA Statement have also commented on the obligation to counsel clients concerning financial disclosure. They are helpful, though of unclear authority. One states:

> *Comment*: The lawyer's obligation to consult with his client concerning unasserted possible claims does not require him to go out of his way to search out or develop facts regarding such possible claims other than those apparent to him from the legal work in which he is engaged or to carry on an investigation of such a matter beyond the point described by the client when the matter is discussed. The obligation rises when, in the course of his other legal services, the lawyer *recognizes* a matter to involve an unasserted possible claim or assessment and, on the basis of the information he has derived in performing such services, has formed a professional conclusion that financial statement disclosure must be made or considered by the client.

First Report, Section on "Unasserted Claims or Assessments," ¶ 2.

Another report of the same committee provides as follows, seeming to indicate that no attorney is obligated to commit to advising a client that disclosure of a possible unasserted claim should be considered under FAS 5:

> The last sentence of Paragraph 6 of the ABA Statement of Policy provides as follows:
>
> > The auditor may properly assume that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, the lawyer has formed a professional conclusion that he client must disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure and the applicable requirements of FAS 5.
>
> This provision is reflected in the procedures established by SAS 12, and lawyers are usually requested in audit inquiry letters to confirm as correct a statement of the client's understanding to the foregoing effect. Concern has been expressed by a number of lawyers that an undertaking to comply with the foregoing standard of professional responsibility, if given by the lawyer, places on him unwarranted and unrealistic obligations in respect of unasserted possible claims. The Committee believes that such concern stems largely from misinterpretation of the above-quoted provision.
>
> By way of preface to a discussion of the intended meaning of certain of the essential terms of this provision, the Committee recognizes that the ABA Statement of Policy was developed for the guidance of the legal profession and does not represent a prescription for lawyer conduct. Accordingly, no lawyer is obliged to enter into an understanding with his client conforming to the ABA Statement of Policy, nor is he obliged to confirm to auditors that such an understanding exists; indeed, if no such undertaking by the lawyer is seriously intended, it would be entirely wrong for the lawyer to do either.[3] In such event, however, the auditor will normally seek some other means of obtaining from the lawyer or others, including other lawyers engaged or employed by the client, corroboration of the information furnished by management concerning unasserted possible claims, in order to satisfy himself concerning

[3] Whether or not the lawyer confirms to the auditor the client's understanding, a response to a letter of audit inquiry stated to be in accordance with the ABA Statement of Policy permits the auditor to make the assumption set forth in the last sentence of Paragraph 6 thereof (quoted above).

compliance by the client with FAS 5.[4] The auditor is in many cases able to obtain the necessary corroboration from the lawyer who advises the client generally concerning disclosure matters.

The Committee also wishes to make clear that any lawyer who confirms an understanding with his client to the foregoing effect, but who does not believe that the above quoted provision is sufficiently clear in delineating the limited scope of his undertaking, is free to clarify this understanding to the client and the auditor in any reasonable manner (for example, see below). In view of the desirability of avoiding differing versions of the same basic undertaking, and recognizing the attendant risks of unintended differences in meaning being derived from differences in wording and phrasing, it is hoped that such *ad hoc* variations will be found unnecessary or kept to a minimum.

There follows a detailed analysis of the undertaking to comply with the standard of professional responsibility set forth in the last sentence of Paragraph 6 of the ABA Statement of Policy (hereinafter referred to as the "Undertaking"). This analysis does not concern, and is not intended to limit in any way, the lawyer's professional responsibilities discussed in Paragraph 6 of the Commentary to the ABA Statement of Policy, including the lawyer's responsibilities under certain circumstances to withdraw from employment in accordance with the Code of Professional Responsibility.

1. Recognition of Matters Involving an Unasserted Possible Claim

As indicated by the Committee's Introductory Analysis and Guides, the Undertaking does not require the lawyer to go out of his way to search out or develop facts or other information regarding unasserted possible claims which do not otherwise become apparent to him from the legal work for the client for which he was retained and in which he is engaged. The Undertaking was not intended to place new responsibilities on the lawyer to ferret out unasserted possible claims or to make lawyers accountable on "should have known" theories.

The threshold requirement of the Undertaking is a subjective one: Does the lawyer recognize the existence of an unasserted possible claim in connection with a matter upon which he is working *and* that such claim may call for financial statement disclosure? The lawyer does not commit to the client that he will devote substantive attention to a search for such claims, or that he will recognize those claims which may call for financial statement disclosure, but only that he will not dismiss without

[4] Reference is made to paragraph 4 of the Commentary to the ABA Statement of Policy and to Paragraph 13 of SAS 12 concerning a limitation on the scope of the audit, and the effect thereof upon the audit opinion, which may result from a refusal to respond to the audit inquiry.

consideration an unasserted possible claim if, in fact, he realizes that one is present in connection with the mater or matters with respect to which he is providing legal services to the client and recognizes that it may call for financial statement disclosure.

2. Recognition that an Unasserted Possible Claim May Call for Financial Statement Disclosure.

The question of recognition by a lawyer that an unasserted possible claim "may call for financial statement disclosure" has apparently proven perplexing to some lawyers, who point out that lawyers are not usually well versed in the field of financial accounting and reporting.[5] By including this element in the "triggering" considerations, it was not intended that the sweep of the Undertaking be expanded. On the contrary, it was included to limit the Undertaking to those matters recognized by the lawyer as having sufficient substance and merit so as to warrant some measure of focused attention, first by the lawyer and, if the lawyer concludes the matter must be brought to the attention of the client, then by the client. The Undertaking does not require the lawyer to bring to the client's attention unasserted possible claims which he regards to be frivolous or otherwise lacking in meaningful substance.

3. Form a Professional Conclusion that the Client Must Consider Disclosing an Unasserted Possible Claim

The Introductory Analysis and Guides also point out that the Undertaking does not require, once an unasserted possible claim is recognized to be a mater which may call for financial statement disclosure, the lawyer to carry on an investigation by searching out or developing facts and information beyond such as are already available to him from the assigned legal work in which he is engaged. On the contrary, the lawyer's consideration of the matter, vis-à-vis advice (*i.e.* notification) to the client, is to be based on the facts and information at hand. On the basis of such facts and information, the lawyer must ask himself whether he can form a conclusion, as a lawyer, that there is sufficient likelihood that (i) the unasserted possible claim is probable of assertion, (ii) if asserted, there is a reasonable possibility that the outcome will be unfavorable, and (iii) the unasserted possible claim is material to the client, so that *the client must consider* whether disclosure of the unasserted possible claim is required.[6] The Undertaking does not require further action on his part unless, on the basis of his existing knowledge, the lawyer concludes the unasserted possible claim recognized by him appears to have a sufficient degree of

[5] As discussed below, the procedure intended for the implementation of the Undertaking does not contemplate that the lawyer assume responsibilities for accounting decisions in the ordinary course.
[6] The client must determine whether or not the assertion of a claim not yet asserted is "probable"; as pointed out in Paragraph 5 of the Commentary to the ABA Statement of Policy, that judgment will infrequently be one within the professional competence of lawyers.

likelihood of assertion and of materiality to the client and, assuming assertion, appears to have a reasonable possibility of an unfavorable outcome. For example, the Undertaking does not require the lawyer to speculate upon (and bring to the client's attention) the myriad unasserted possible claims which a fertile imagination, given unlimited time and free rein, might conjure up. The lawyer undertakes only to contact the client when, on the basis of the information in his possession, the lawyer has formed a professional conclusion that the client must – *i.e.*, is required – consider disclosure of the unasserted possible claim which the lawyer has recognized to be such and to be a matter which may call for financial statement disclosure.

4. Advising and Consulting with the Client Concerning an Unasserted Possible Claim

The lawyer's primary obligation to his client with respect to an unasserted possible claim, concluded by him to require consideration by the client for disclosure, is to bring the existence of the matter to the attention of a responsible officer or employee of the client (in many cases, inside counsel may provide a suitable channel of communication) so that the client may deal with the matter in such appropriate manner as the client may determine. The lawyer should satisfy himself that the officer or employee so notified is generally aware of the disclosure requirements of FAS 5 in respect of unasserted possible claims and understands the lawyer's view that the reported claim must be considered by the client in relation to such obligations.

The lawyer should also make clear to the person so notified his willingness, within the limits of his knowledge and training, to consult further with the client, or otherwise assist the client, in the client's consideration of the probability of assertion, the risk of unfavorable outcome, and the materiality to the client of the possible claim. It is likely that, in every case, the lawyer would consult with the client by describing the nature of the possible claim and why the lawyer felt it appropriate to call the matter to the client's attention. If the client also solicits the lawyer's views (such as those bearing on the probability of assertion of the claim or the dimensions of its possible materiality), the lawyer should, of course, consult with the client to the extent he is able to do so. <u>If the lawyer does not normally advise concerning matters of disclosure and may not have sufficient training or experience to do so with confidence, he may note this to the client and offer to make himself available, if the client so desires, to consult with (i) a member of management familiar with financial accounting and reporting who would be in a position to interpret the disclosure requirements of FAS 5 as they relate to the matter at hand, and/or (ii) inside or outside counsel for the client who normally advise the client concerning questions of disclosure</u>.

The lawyer has discharged his responsibilities to the client if he has notified an appropriately responsible officer or employee of the client concerning the existence of the unasserted possible claim which the lawyer has concluded must be considered by the client for disclosure, has satisfied himself that the person so notified understands the need to consider disclosure of such matter in relation to the requirements of FAS 5, and has provided such person with such information or views as the lawyer has on the basis of his professional competence and experience and of his presently available knowledge of the matter. If the client does not request the lawyer to proceed further, the lawyer need not do so, and he has no responsibility with respect to the client's consideration of and conclusions in respect of disclosure of the unasserted possible claim *unless* the lawyer has advised the client that the lawyer has concluded, as a matter of law, that the unasserted possible claim is probable of assertion and must be disclosed.[7] If the client does request the lawyer to proceed further, the lawyer need do so – and should do so – only to the extent that he has the professional competence and experience to assist in the client's further consideration of the matter.

5. Form of Advice to Client

There is no requirement that the lawyer advise the client concerning unasserted possible claims in any prescribed manner. Such advice may be oral as well as written. A lawyer may, however, find it useful, recognizing that a question might arise at a later date concerning performance of his undertaking to his client, to have some record of his having brought an unasserted possible claim to the client's attention.

6. Limitations on the Undertaking

The Undertaking, as set out in the illustrative forms of response to the audit inquiry included in Annex A to the ABA Statement of Policy, is couched in terms of the future (*i.e.*, the lawyer "*will* advise" and "*will* consult"). While the Undertaking cast this way, may be appropriate for the lawyer representing the client on a regular basis, it may not make sense for this lawyer retained to act in a limited capacity, such as special counsel in a lawsuit or other matter where there is no expectation on the part of either the client or the lawyer that a relationship will be maintained following its disposition.

In such circumstances, consideration should be given by the client to omitting the Undertaking from the letter of audit inquiry addressed to such lawyer. If the lawyer is requested to confirm the Undertaking, it would be appropriate for him to comment upon the practicality of his

[7] See Paragraph 6 of the ABA Statement of Policy and of the accompanying Commentary; also see Paragraph 5d of SAS 12.

future involvement with unasserted possible claims against the client due to the limited scope of his engagement (which may have been completed when the audit inquiry is made).

Depending upon the circumstances, the lawyer may wish to refer back to the description of his engagement or provide other clarifying comment to communicate to the auditor (and his client) special circumstances or considerations bearing upon his confirmation of the Undertaking.

ADVICE CONCERNING DISCLOSURE DOES NOT REQUIRE THE LAWYER TO DETERMINE THE CONTENT OF FINANCIAL STATEMENTS

The ABA Statement of Policy does not require the lawyer to make determinations of what should be included in financial statements or to undertake interpretation of FAS 5 or other accounting requirements. It does recognize, however, that (i) in certain circumstances, as contemplated by the last paragraph of the Commentary to Paragraph 6 of the ABA Statement of Policy, the need for disclosure in the client's financial statements may have become clear to the lawyer and (ii) the lawyer may advise the client concerning the need for disclosure of loss contingencies which are directly relevant to the preparation by the client of its financial statements. A more detailed analysis follows:

1. Legal Advice Concerning Disclosure

As noted in Paragraph 6 of the ABA Statement of Policy, the lawyer may have as a part of his professional engagement the responsibility to advise the client concerning the need for or advisability of *public* disclosure of a wide range of events and circumstances – totally separate and apart from financial statement presentation. The lawyer's role in this regard is not affected by the ABA Statement of Policy. As a practical matter, the initial consideration by such a lawyer of an unasserted possible claim, recognized by him or another lawyer and referred for his consideration, will in all likelihood be in the context of advising the client concerning timely *public* disclosure in a press release, periodic report or registration statement filed with the Securities and Exchange Commission or otherwise.

Even lawyers who may not have been engaged to advise concerning public disclosure matters, and may not have sufficient training or experience to do so with confidence, have traditionally advised concerning required disclosure to third parties. For example, such lawyers often have occasion to advise clients on disclosure matters in dealings with third parties, such as governmental agencies, bank lenders or other parties having commercial relationships with the client, where the absence of disclosure would or could give rise to fraud. An unasserted possible claim which such a lawyer recognizes must be considered by the client for financial statement presentation (see discussion above would, in most instances, involve the same types of matters as he would normally consider, as part of his professional duties, in the context of disclosure to a third party.

In sum, the *recognition* of an unasserted possible claim, and the consideration of the need for its disclosure (albeit not in the context of financial statement presentation), is a function with which lawyers have some measure of familiarity.

2. Interpretation of FAS 5

The relevant portions of FAS 5 have been made readily accessible to the lawyers by the publication of excerpts of FAS 5 in Appendix A to the ABA Statement of Policy. In addition, many lawyers, by reason of their training and experience, may be in a position to advise a client concerning the requirements of FAS 5. Neither the ABA Statement of Policy nor the professional responsibility undertaking stated in Paragraph 6 thereof, however, contemplates that the lawyer undertake any interpretation of FAS 5 as it may apply to a particular unasserted possible claim. Unless it has become clear to the lawyer that a disclosure in the client's financial statements is beyond reasonable dispute required, such professional responsibility undertaking requires only that the lawyer bring the existence of the matter to the attention of the client, satisfy himself that the client is aware that the matter must be considered in relation to FAS 5, and consult with the client concerning the matter. To the extent desired by the client, the layer may also provide such information and views as may be within the possession and competence in order to aid the client in its consideration of the need for disclosure in its financial statements.

3. Disclosure to the Auditor

When the ABA Statement of Policy refers to disclosure, in the context of financial statement presentation, the disclosure which is intended is whether or not the unasserted possible claim must or should be brought to the attention of the auditor by the client. It is not intended that the lawyer make a determination as to the need for the disclosure to be made in the client's financial statements as such, since such a determination is one to be made by the client (subject to review by the auditor). This is equally true with respect to those situations where the lawyer has formed a professional conclusion that the unasserted possible claim is probable of assertion and must be disclosed (*i.e.*, must be disclosed *to the auditor*). Subject to the auditor's responsibility to evaluate conformity of financial statement presentation with generally accepted accounting principles, it is the client who should properly make

> the ultimate determination whether or not disclosure of an unasserted possible claim in the financial statements is required by FAS 5, and the client should look to and rely upon the auditor for interpretation of FAS 5. The lawyer's role in advising concerning timely public disclosure, separate and apart from financial statement presentation, should be distinguished; adequate public disclosure may be required, but this may often be accomplished in ways other than or in addition to disclosure in the client's financial statements.

(emphasis added) Second Report, Section on "A Lawyer's Professional Responsibility to His Client With Respect to Matters Recognized to Involve an Unasserted Possible Claim."

<u>FIN 48</u>. FAS 5 does not apply to accounting for <u>income taxes</u>. Instead, that accounting is determined under Financial Accounting Standards Board Interpretation No. 48 ("**FIN 48**"), titled "Accounting for Uncertainty in Income Taxes." FIN 48 is an interpretation of Financial Accounting Standards Board Statement No. 109 ("**FAS 109**"). FIN 48, ¶ 3 and Appendix C ¶ C2.a n. 1a. Importantly, the standard under FIN 48 for recognizing the financial statement effects of a tax position does not turn on whether an outcome is probable, remote, or neither (as under FAS 5), but instead on whether the it is "more likely than not" that the position will be sustained upon examination. FIN 48 ¶ 6. If it is more likely than not that a tax position will be sustained upon examination, the client is to recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. FIN 48, ¶ 8 and Appendix A ¶¶ A2 and A4.

The "more likely than not" and "greater than 50 percent" standards under FIN 48 for recognizing the effects of a tax position raise the question whether, in making disclosure to an auditor at a client's request concerning qualified retirement plans or other benefit issues having a tax impact, the attorney may continue to evaluate matters under the "probable" and "remote" rubric of the ABA Statement. The ABA Business Law Section's Audit Response Committee, in a draft document dated November 15, 2007 and titled "Statement of Effect of FIN 48 on Audit Response Letters," concluded that:

> For purposes of preparing an audit response letter, a lawyer should continue to follow the usual practice regarding whether or not to comment on the expected outcome of asserted and unasserted claims disclosed in the audit response letter, but leave it to the client to assess the likelihood and amount likely of being realized, using the lawyer's assistance as necessary as tax counsel to the client. The lawyers' professional responsibility to advise the client regarding its disclosure obligations continues to apply.

As to the responsibility to advise the client regarding its disclosure obligations with respect to unasserted claims relating to income taxes, this same November 2007 draft states:

> Paragraph 38 of FAS 5 (which is quoted in the Commentary to the Treaty) discussed when assertion of an unasserted possible claim is to be considered probable, and leaves to the client to determine whether assertion of the claim is probable, and leaves to the client to determine whether assertion of the claim is probable (i.e., likely to occur). If the client determines that assertion is not probable, then no accrual or disclosure is required, and so long as the lawyer believes the client has a reasonable basis for its determination, the lawyer is not required to disclose the unasserted claim in the audit response letter or take other action.
>
> FIN 48 has amended Paragraph 38 of FAS 5 to make Paragraph 38 inapplicable to income taxes, and proceeds on the assumption that, in assessing whether the client satisfies the "more likely than not" criterion, it is to be presumed that the client's tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information (see Paragraph 7a of FIN 48). Accordingly, a lawyer can no longer rely on the client's judgment that a taxing authority will not assert a claim against the client in determining what to report with respect to unasserted contingencies relating to income taxes. Instead, in cases where the lawyer has rendered substantive advice to the client with respect to a material unasserted contingent liability relating to income taxes, if the client does not take the initiative in asking the lawyer to mention the contingency in the audit response letter, the lawyer should remind the client of its obligation under FIN 48, and if the lawyer is not satisfied that the auditor has been or will be made aware of the material unasserted claim concerning income taxes to which the lawyer has devoted substantive attention, the lawyer should consider whether to withdraw from the engagement or take other remedial action.

The upshot, under both FAS 5 (for non-tax matters) and FIN 48 (for tax matters), seems to be that an attorney should not volunteer information about unasserted claims the client has not specifically identified in its letter requesting disclosure. Where, however, the attorney has formed a professional judgment that the client must disclose or consider a disclosure, the attorney should so advise the client. If, as a matter of professional responsibility, the attorney concludes that disclosure is required and the client refuses to disclose, the attorney may need to consider withdrawal from the engagement or "other remedial action." Annotated Model Rule 1.6. The Commentary to the ABA Statement explains this as follows (citing the pre-Model Rule ethical standards):

> [W]here, in the lawyer's view it is clear that (i) the matter is of material importance and seriousness, and (ii) there can be no reasonable doubt that its non-disclosure in the client's financial statements would be a violation of law giving rise to material claims, rejection by the client of his advice to call the matter to the attention of the auditor would almost certainly require the lawyer's withdrawal from employment in accordance with the Code of Professional Responsibility. (See, e.g., Disciplinary Rule 7-

> 102(A)(3) and (7), and Disciplinary Rule 2-110(B)(2).) Withdrawal under such circumstances is obviously undesirable and might present serious problems for the client. Accordingly, in the context of financial accounting and reporting for loss contingencies arising from unasserted claims, the standards for which are contained in FAS 5, clients should be urged to disclose to the auditor information concerning an unasserted possible claim or assessment (not otherwise specifically identified by the client) where in the course of the services performed for the client it has become clear to the lawyer that (i) the client has no reasonable basis to conclude that assertion of the claim is not probable (employing the concepts hereby enunciated) and (ii) given the probability of assertion, disclosure of the loss contingency in the client's financial statements is beyond reasonable dispute required.

ABA Statement, Commentary ¶ 6.

Privilege vis-à-vis the IRS. The IRS, under Internal Revenue Code Section 7602, generally has the power to examine any books, papers, records, or other data which may be relevant or material to the determination of a taxpayer's tax liability. Code Section 7525 does, however, require the IRS to honor the same common law protections of confidentiality which typically apply to communications between a taxpayer and an attorney. This protection is extended not only to communications with attorneys, but also to communications with other "federally authorized tax practitioners," which would include CPAs. This Code Section 7525 privilege applies, however, only with respect to "tax advice," and not with respect to a tax practitioner's "work product" in *preparing* a return nor to "communications between a tax practitioner and a client simply for the preparation of a tax return." *U.S. v. KPMG, LLP*, 316 F.Supp.2d 30, 35 (D.D.C. 2004), cited in *U.S. v. Textron Inc. & Subsidiaries*, 507 F.Supp.2d 138, 147 (D. R.I. 2007).

Under its current policy, the IRS will generally seek tax accrual work papers only in limited circumstances, such as where taxpayers claim the benefits of a listed transaction. IRS Announcement 2002-63. Of concern is the case of *U.S. v. Textron Inc. & Subsidiaries*, 507 F.Supp.2d 138 (D. R.I. 2007), where the IRS did summons tax accrual work papers. The court in *Textron* concluded that attorney-client privilege was lost when Textron provided its work papers to its independent auditor, even though Textron permitted its auditor to examine tax accrual work papers only with the understanding that the information was to be treated as confidential. Despite the loss of attorney-client privilege, the Service failed in obtaining the work papers, because the requested documents were protected by the work product privilege.

Sarbanes-Oxley. The wildcard concerning an attorney's disclosure obligations to auditors of a public company is the effect of Section 303 of the Sarbanes-Oxley Act of 2002 ("SOX"). SOX established the Public Company Accounting Oversight Board (the "PCAOB") to oversee the audit of public companies subject to the securities laws. SOX § 101(a). The PCAOB is charged with establishing auditing standards for public companies, which it may, if it wishes, do by adopting standards proposed by one or more professional groups of accountants. SOX § 103(a)(1). Although the PCAOB has the power to set auditing standards for public companies, it does not directly set financial statement standards. The PCAOB, in its Rule 3200T, has adopted as interim auditing standards for public companies the AICPA's "Standards of Fieldwork," which include SAS 12 (as AU 337). SEC Rel. No. 33-8222 (which is also Rel. No. 34-47745).

Importantly, SOX makes it illegal for any officer or director of an issuer of securities, or any other person "acting under the direction thereof," to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of the issuer for the purpose of rendering such financial statements materially misleading. SOX § 303(a). The SEC has indicated that this proscription can cover attorneys. SEC Rel. No. 34-47890 (Section captioned "Definition of 'under the direction'"). Although the statute's prohibition, by its literal terms, applies only where the proscribed act is "for the purpose of rendering such financial statements materially misleading," the SEC regulations substitute a lower standard for violation of the provision. Under that lower standard, a listed action will be illegal if the person "knew or should have known that such action, if successful, could result in rendering the issuer's financial statements materially misleading." 17 CFR § 240.13b2-2(b)(1).

The SEC proposing release for the Commission's regulations interpreting Section 303 offers examples of ways in which an attorney might improperly influence an auditor. One way would be to put "pressure on an auditor to limit the scope of an audit, to issue an unqualified report on the financial statements when such a report would be unwarranted, to not object to an inappropriate accounting treatment, or not to withdraw an issued opinion on the issuer's financial statement." Importantly, the SEC also included "providing an auditor with inaccurate or misleading legal analysis" in its examples.

The degree to which the SOX Section 303 obligation to auditors will limit an attorney's ability to fail to provide information (where the attorney acts in a fashion consistent with the Treaty) is as yet unclear. Nevertheless, when responding to a direction by a public company client to make disclosure to an auditor, one should consider carefully whether a fuller response is required than is called for under the Treaty, and if so, how to balance that obligation with the attorney's ethical obligation to safeguard the client's confidences and secrets. It may be that the proper course will be to rely heavily on gaining the client's informed consent for disclosure.